

BellSouth
Suite 900
1133-21st Street, N.W.
Washington, D.C. 20036-3351

robert.blau@bellsouth.com

Robert T. Blau, Ph.D., CFA
Vice President-Executive and
Federal Regulatory Affairs

202 463-4108
Fax 202 463-4631

September 11, 2002

Ms Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

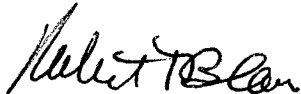
Re: CC Docket No. 01-338

Dear Ms Dortch:

On September 4, 2002 BellSouth filed the attached ex parte notice under an incorrect docket number.

In accordance with Commission rules, I am filing two copies of this notice and request that they be included in the record of the proceeding identified above.

Sincerely,



Robert T. Blau

Attachment

cc: Chairman Powell
Christopher Libertelli

STAMP & RETURN

BELLSOUTH

BellSouth
Suite 900
1133-21st Street, N.W.
Washington, D.C. 20036-3351

robert.blau@bellsouth.com

Robert T. Blau, Ph.D., CFA
Vice President-Executive and
Federal Regulatory Affairs

202 463-4108
Fax 202 463-4631

September 4, 2002

RECEIVED

Ms Marlene H. Dortch
Secretary
Federal Communications Commission
The Portals
445 12th Street, S.W.
Washington, D.C. 20554

SEP - 4 2002
FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Re: WC Docket No. 01-339

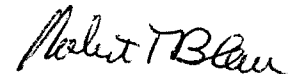
Dear Ms Dortch:

This is to inform you that on September 3, 2002, Duane Ackerman, Ronald Dykes Margaret Greene, and I, all representing BellSouth, met with Chairman Michael Powell and his legal advisor, Christopher Libertelli to discuss some of the more pressing financial challenges facing local exchange carriers, and the telecom industry more generally.

Topics addressed during the course of this meeting are summarized in the attached presentation.

In accordance with Section 1.1206, I am filing two copies of this notice and request that you place it in the record of the proceeding identified above. Thank you.

Sincerely,


Robert T. Blau

cc: Chairman Powell
Christopher Libertelli

Attachments

Wireline Telecommunications: Situation Analysis and Recommendations

September 3, 2002

Executive Summary

- The Telecom industry is caught in the midst of a financial crisis created by three dynamics which have together resulted in massive excess industry capacity and destructive competition:
 - Internet “explosion”
 - Economic downturn
 - Telecom Act Implementation
- The combination of these dynamics has created a situation that carries huge, *long-term* negative implications for telecom investment, innovation and universal service.
- The number of business failures within the industry and the nature of bankruptcy law will exacerbate the situation.
- Specific changes in the regulatory framework provide the single best lever to stabilize the sector in the near-term.

Discussion Outline

- Current State of the Telecom Industry
- Current State of BellSouth's Wireline Business
- What Happened?
- Proposed Solutions

Current State of the Telecom Industry

- **As a significant part of the U.S. economy as well as the core infrastructure, the Telecom industry has the potential to be a long-term drag on the overall economy's growth and productivity.**

- **Massive Excess Capacity.** Industry analysts estimate that less than 97% of the fiber in the US has been lit.

- **Diminished Investor Confidence and Constrained Access to Capital.**
 - » 6 of 7 major domestic wireline carriers' debt has been downgraded since January 2000. Of these companies, two are rated as "junk" and two others are near junk status.
 - » Equity capital raised by Telecom carriers has declined from \$31B in 1999 to \$7B in the first half of 2002.

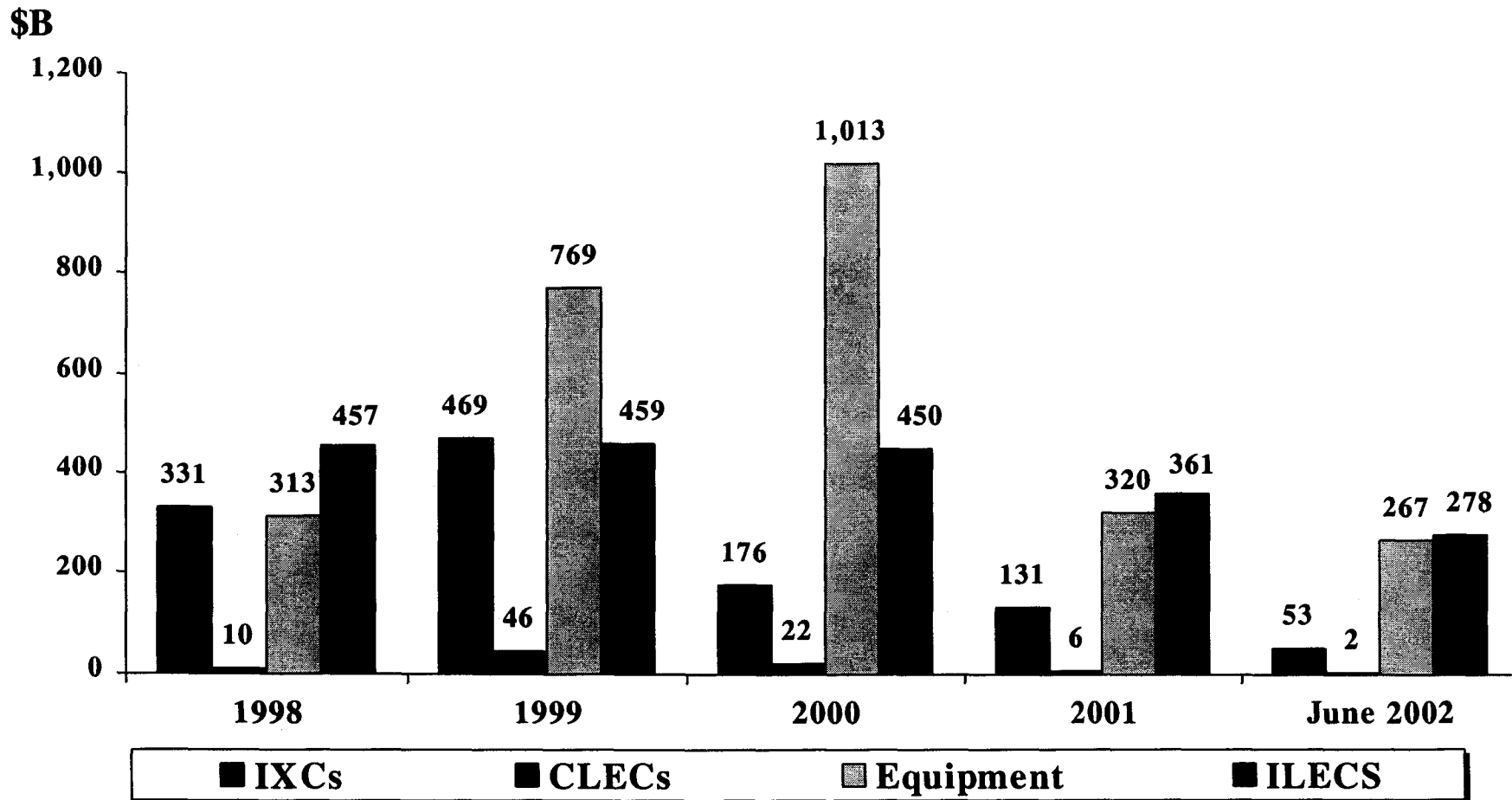
- **Reduced Capital Spending / Innovation.** Annual Telecom capital spending will decline from \$97B in 2001 to a projected level of \$69B in 2002 (28%).

- **Declining Revenue Growth.** Telecom industry revenue growth has declined from 11% in 1998 to a 3% decline in 1st Qtr 2002.

- **Widespread Layoffs and Bankruptcies**
 - » Over 80 bankruptcies have been filed in the Telecom sector since January 2000.
 - » Telecom layoffs have exceeded all industries in 9 of the last 12 months, and announcements total more than 600,000 since January 2000.

Current State of the Telecom Industry

- The implosion of the Telecom industry has resulted in the destruction of \$1.4 trillion in shareholder value (from each segment's high point).

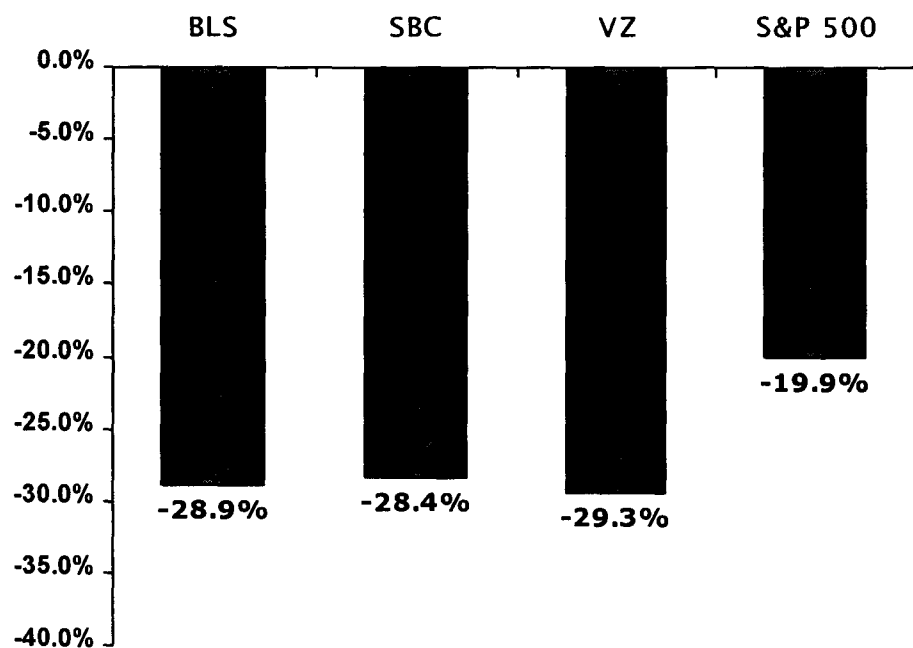


Current State of Telecom Industry

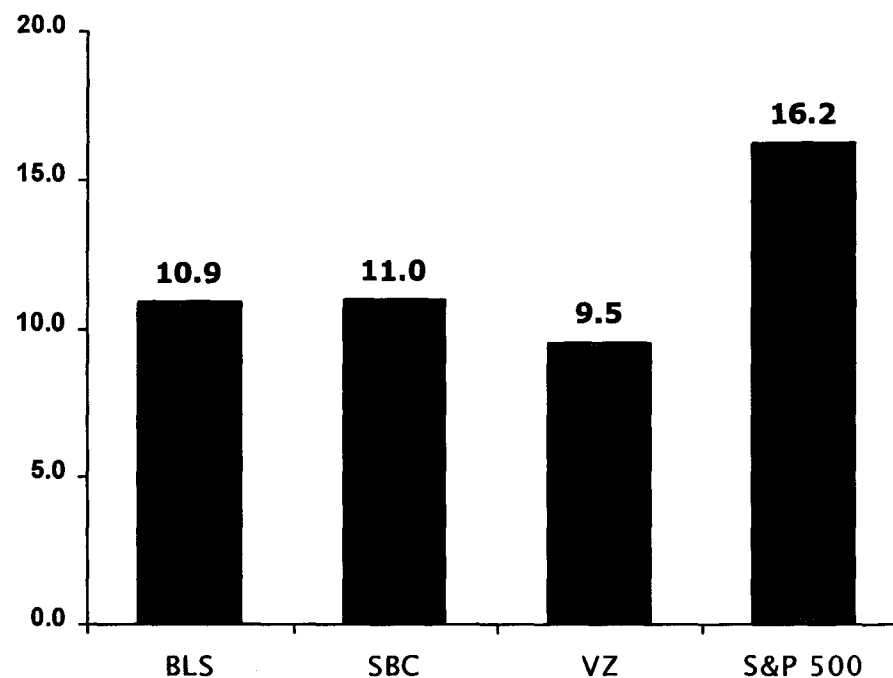
- Far from being immune, ILECs are increasingly viewed as high risk due in part to heightened analyst understanding of UNE-P impact. BellSouth, along with the other ILECs, are trading at historically high discounts to the market.

2002 Shareholder Returns

Through 8/5/02



Current P/E Comparisons



Current State of BellSouth's Wireline Business

- **BellSouth's financial situation is not unlike the rest of the Telecom industry, just a little behind in terms of timing.**

- **Competition** - Accelerating declines in access lines, revenues and margins driven by intense wireline and wireless competition.

- **New Products** - (primarily DSL and LD) once thought to be the equalizer, offer increasingly lower margins than traditional services and carry unknown regulatory risks.
 - » The LD market is now in systemic decline driven by wireless competition and excess capacity.
 - » DSL is under review by state regulators who want to unbundle the service, significantly raising the risk profile of any potential investment.

- **Cost Structure** - Substantially fixed, dominated by labor and investment-related costs.

- **Trends** - Declining revenues are placing substantial pressure on capital spending and employment levels in order to attempt to maintain profitability and returns.

- **Result** - Driven by factors above, Telecom industry stock valuations reflect a historically high discount to market, and year-to-date shareholder returns significantly lag the broader market. Investors are abandoning the sector due to the risk/return profile.

Current State of BellSouth's Wireline Business – Competition

➤ **Competitive activity in the BellSouth markets continues to be robust.**

- 354 CLECs providing local telephone service (*up 61, or 21 %* since January 1st) to over 4.4 million lines.

- » 3,930 collocation arrangements in 548 wire centers
- » 297 operational Competitor switches
- » 259 operational points-of-interface (POIs) connected to the BellSouth network

- Competitive lines served on the BellSouth network:

- » Resale: 543K (2.1 % of total lines)
- » UNE-Platform: 1,115K (4.3 % of total lines)
- » UNE Non-Data Loops: 365K (1.4 % of total lines)
- » UNE Data Loops: 40K

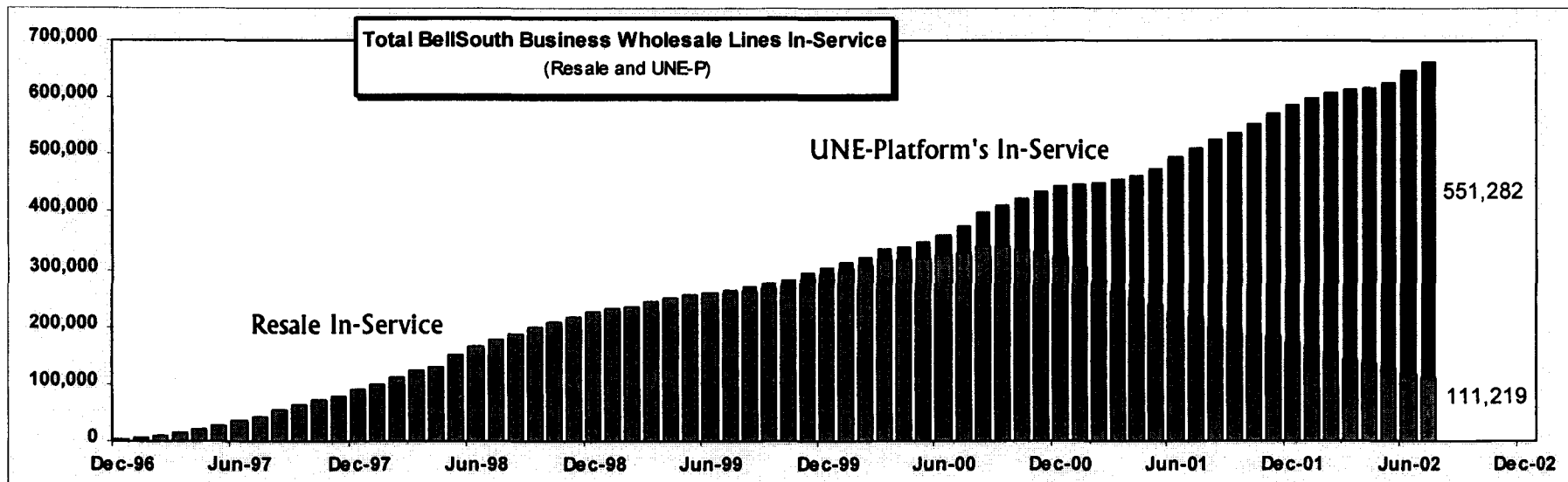
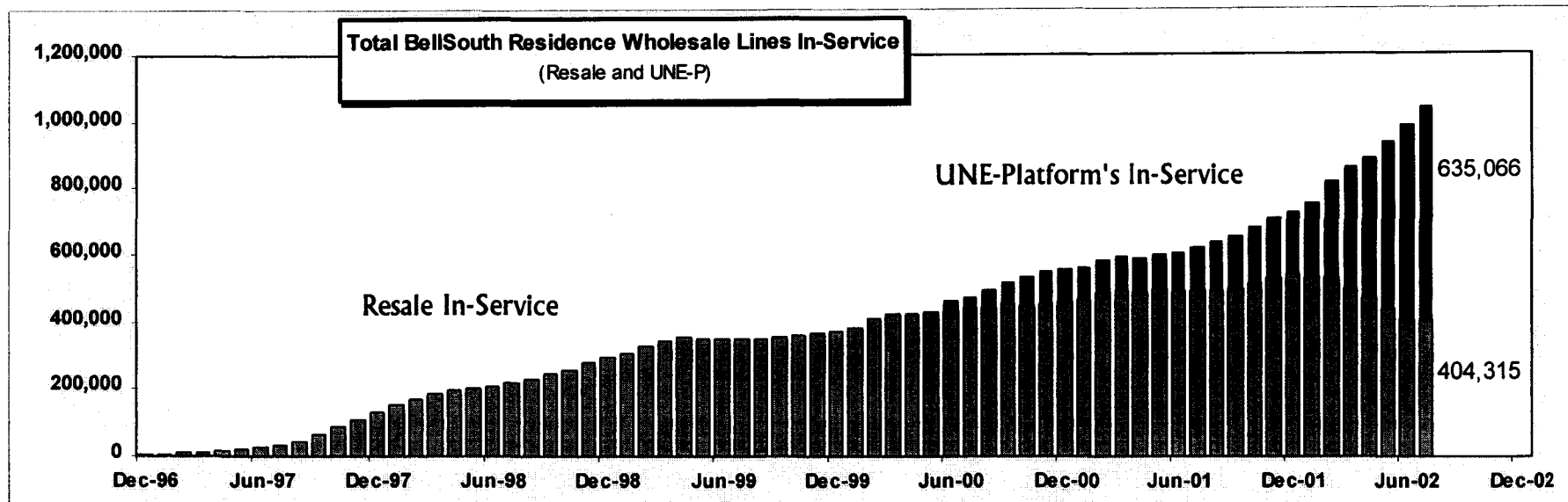
- Estimated additional Competitive lines served **entirely off the BellSouth network**: 2,305K (8.4 % of total lines)

- Estimated BellSouth Retail Market Share:

- » Residence: 15,755K (92 % of total residence lines)
- » Business: 5,887K (66 % of total business lines)

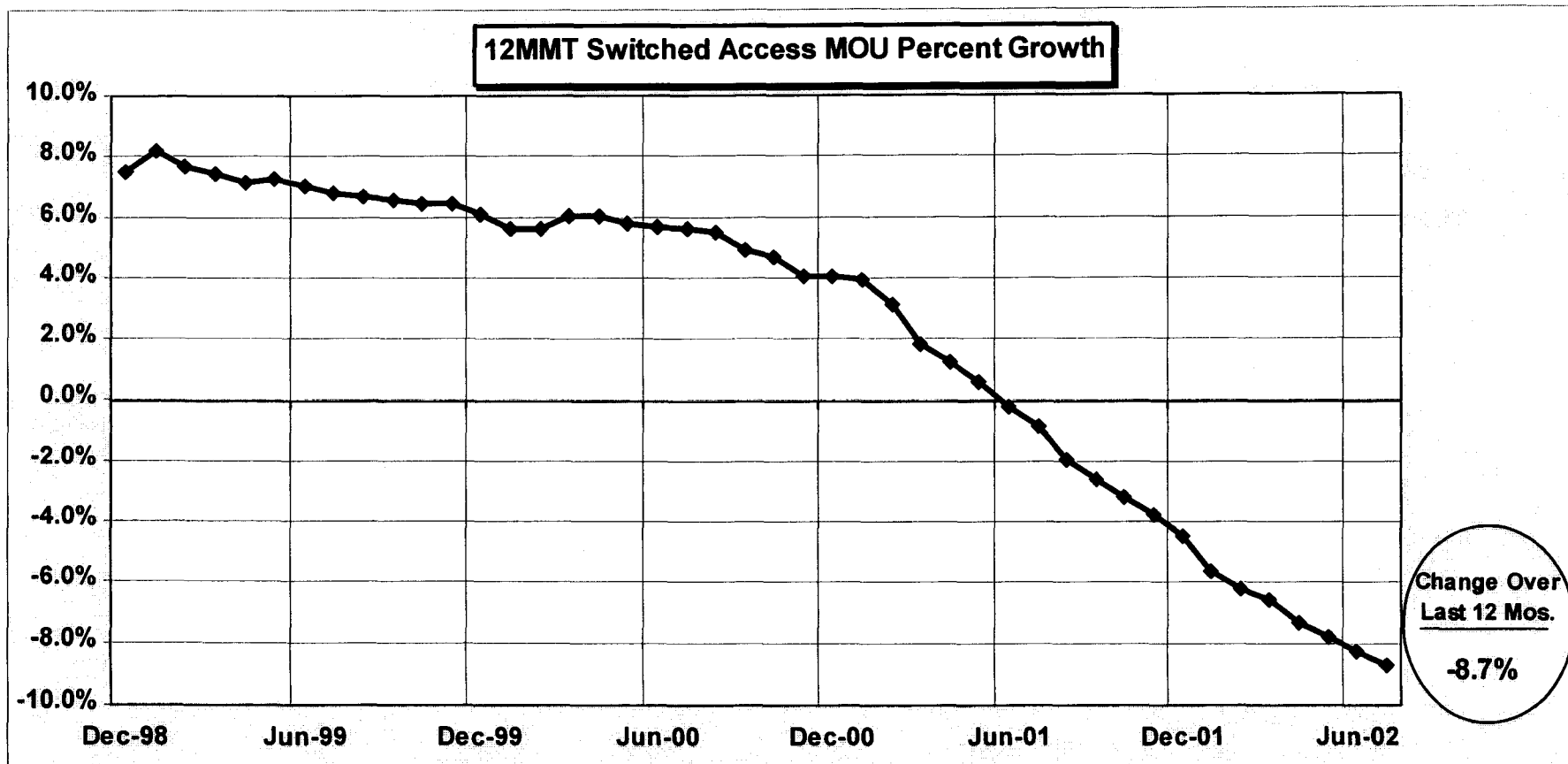
Current State of BellSouth's Wireline Business – Competition

- ... even with the financial turmoil in the industry more competitors jump on UNE-P capturing the arbitrage opportunity...



Current State of BellSouth's Wireline Business – Competition

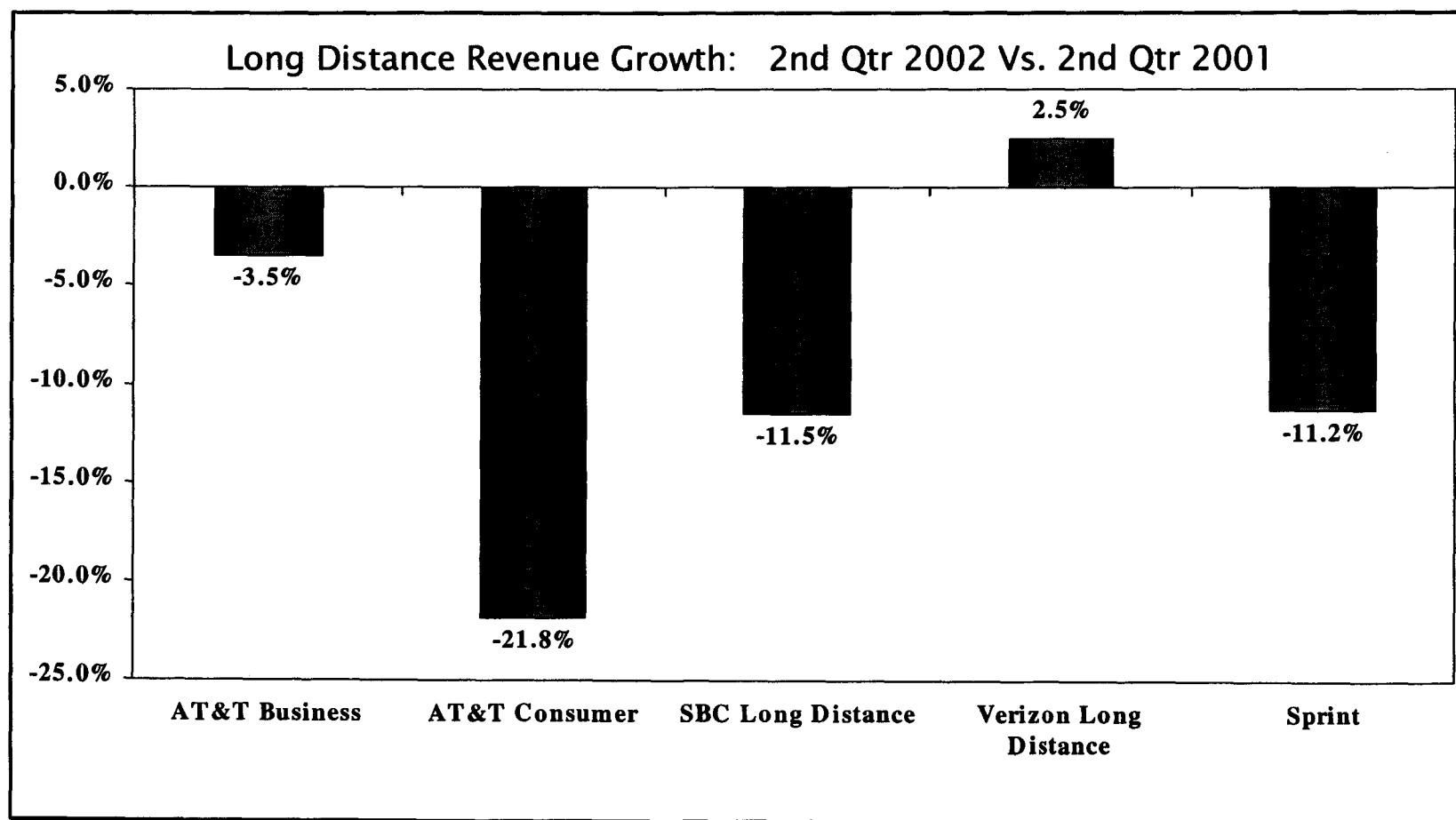
- Competition from wireline and wireless providers continues to drive down network usage, which drives BellSouth's \$1.0B Switched Access revenue stream.



... that same competition negatively effects a new revenue stream which we have invested in and planned on to help offset the competitive erosion in our wireline business ...

Current State of BellSouth's Wireline Business – New Products

- While still critical to BellSouth's product "bundle," the revenue and contribution growth potential associated with Long Distance is limited as a result of intense wireline and wireless competition.



Current State of BellSouth's Wireline Business – New Products

- **Driven by wireless competition and excess capacity, long distance margins have declined significantly.**

USB Warburg States:

**“... they will need to add
5.4 LD customers for every
local line lost just to break
even at the EBITDA line.”**

Current State of BellSouth's Wireline Business – New Products

- **DSL is under review by state regulators who want to unbundle the service, significantly raising the risk profile of any potential investment. Yet, BellSouth's market share lags that of its competitors.**

BellSouth Investment in DSL

Investment

- Cumulative network deployment: \$1.1 billion
- Cumulative negative operating cash flow: \$0.4 billion
- Cumulative negative free cash flow: \$1.5 billion

Coverage

- Regional household coverage: 72%
- Total wire center deployment: 80% (1,282 wire ctrs)

Subscribers

- Total subscriber base: 803K (as of 06/30/02)
- Household penetration: 5%

Competitive Position

- **BellSouth Residential Market Share: 42%**
- Estimated end of year, in-region competitor cable modem subscribers: 1.1 million

PSC Actions Related to DSL

FL – As a result of the FDN and Supra arbitrations, PSC has required DSL to be offered of UNE-P

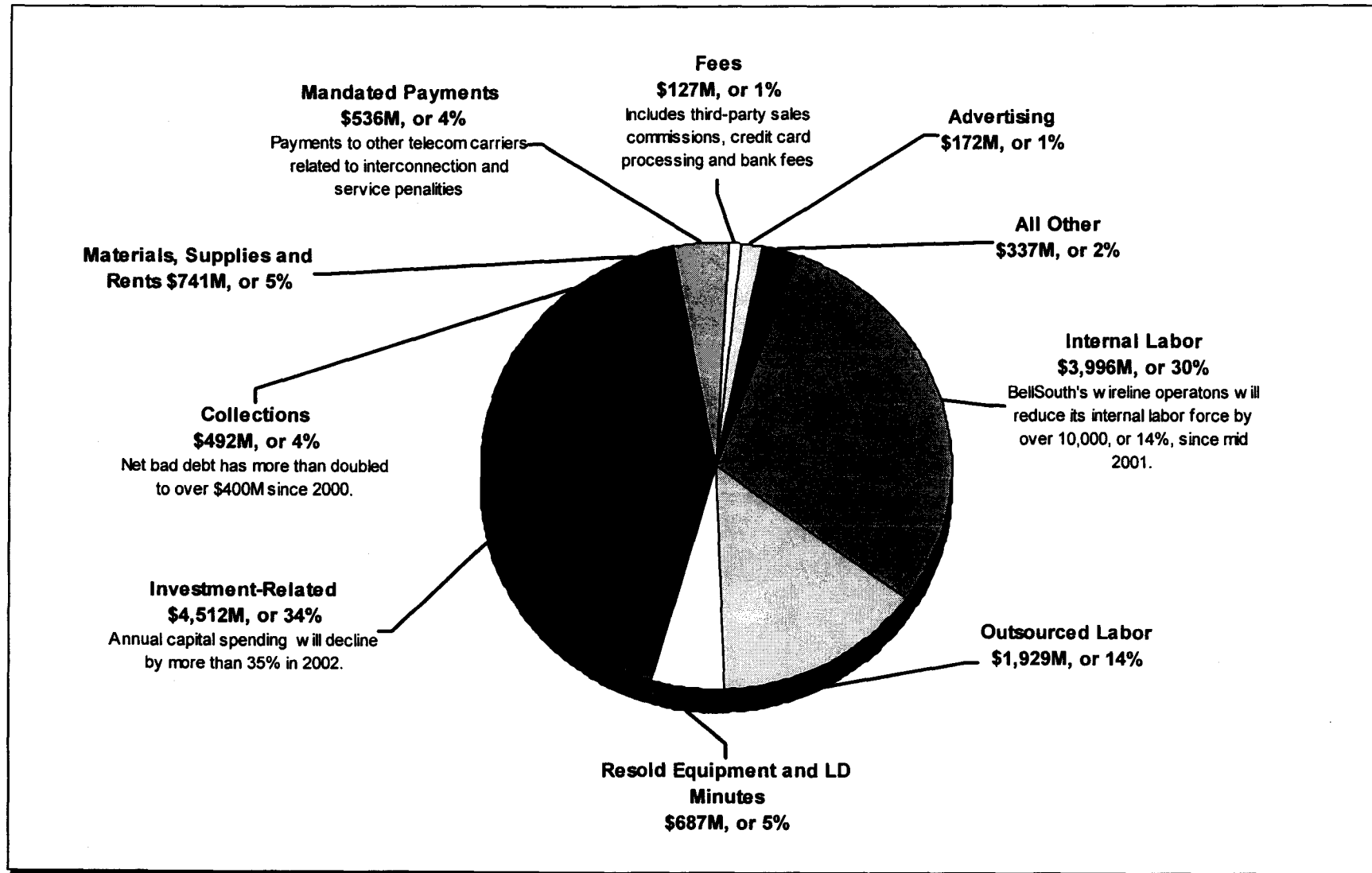
GA – As a result of MCI complaint, PSC is considering DSL over UNE-P

KY – In the Cinergy arbitration, PSC required DSL over UNE-P and is considering requiring unbundled packet switching.

LA – Commission staff has recommended that the PSC require BellSouth to offer DSL over UNE-P.

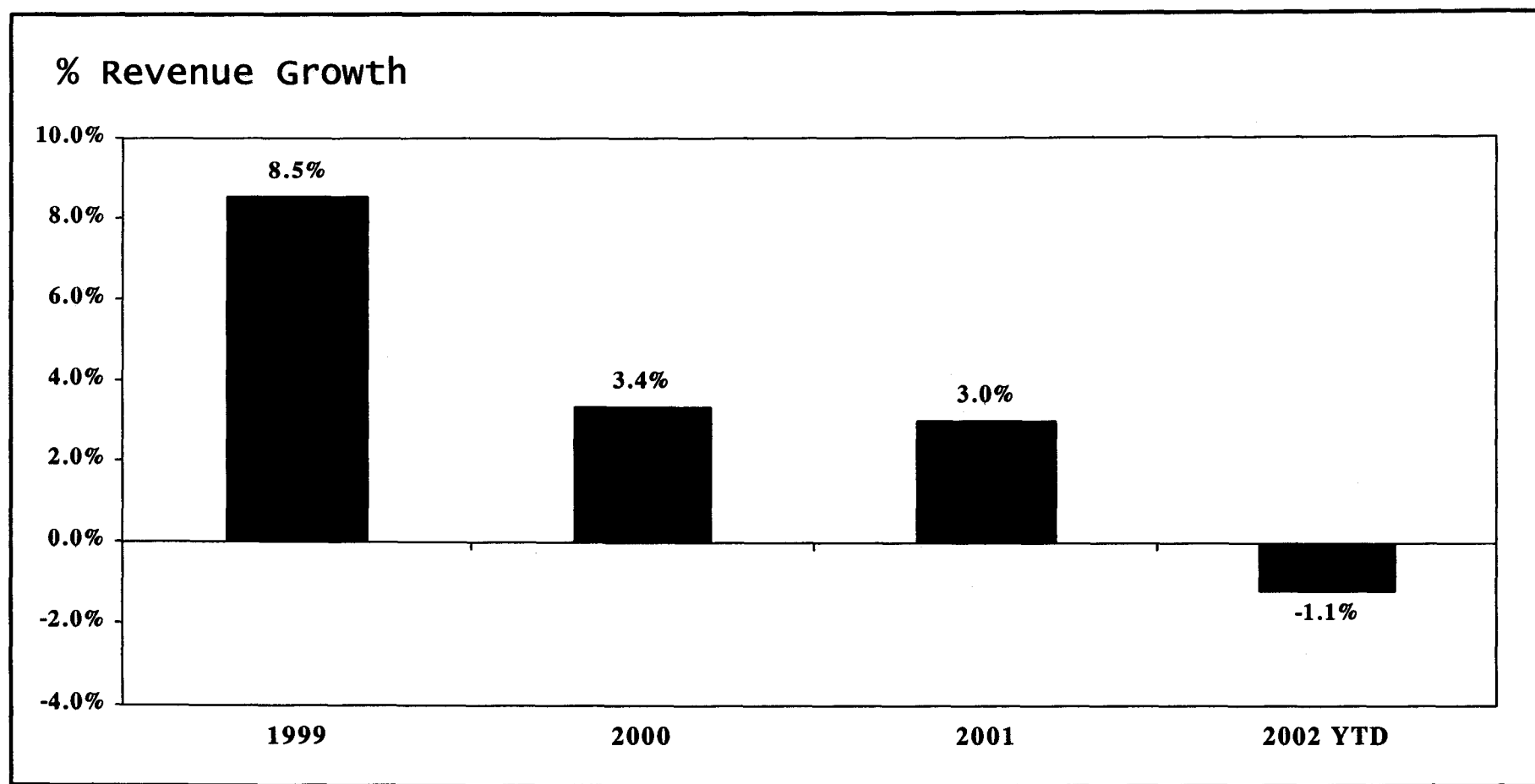
TN – In the generic UNE docket, PSC ordered implementation of “Dual Purpose Line Cards” which in effect unbundles packet switching. PSC is also reviewing DSL over UNE-P in an accelerated docket.

Current State of BellSouth's Wireline Business – Cost Structure



Current State of BellSouth's Wireline Business – Trends

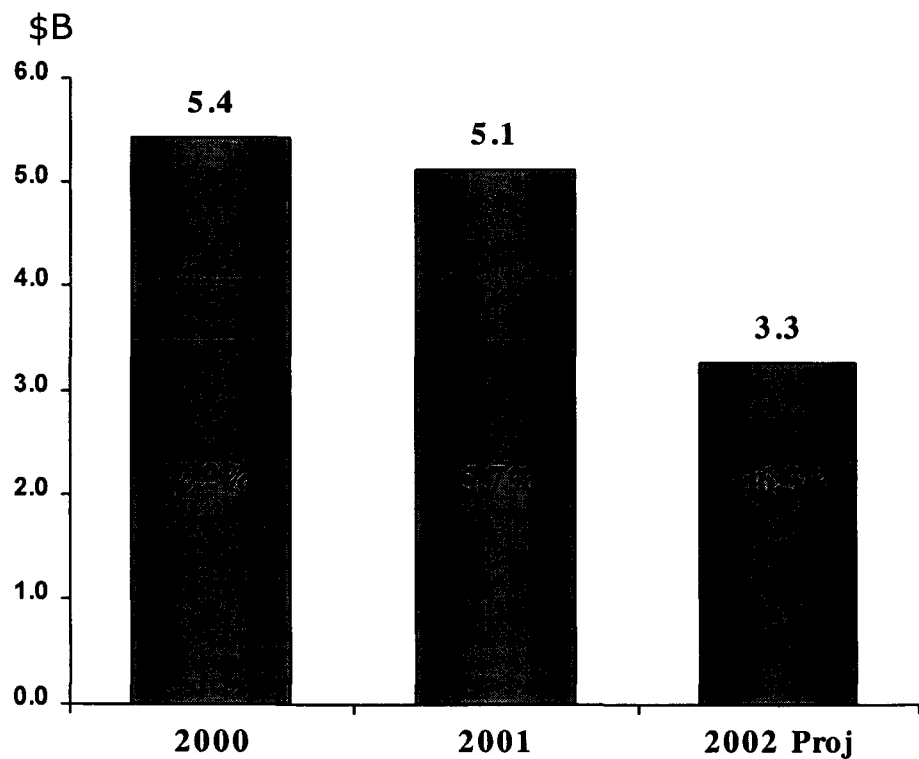
- The cumulative affect of access line losses to wireline and wireless competitors has driven BellSouth's top line growth negative in 2002.



Current State of BellSouth's Wireline Business – Trends

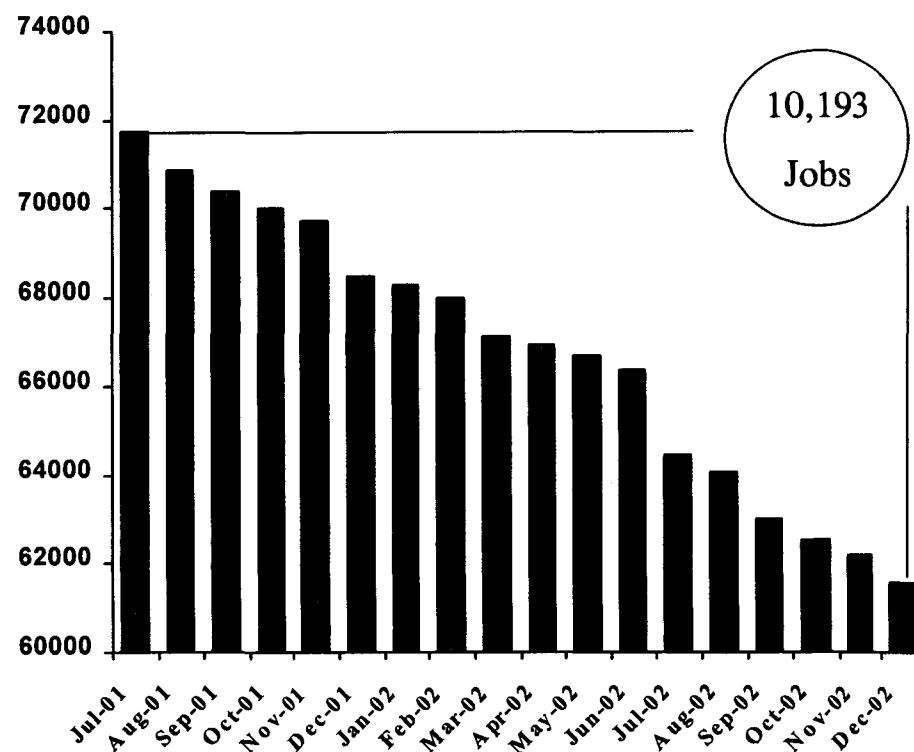
- Declining revenues have placed substantial pressure on capital spending and employment levels in order to attempt to sustain asset returns and strengthen the balance sheet.

Annual Capital Spending



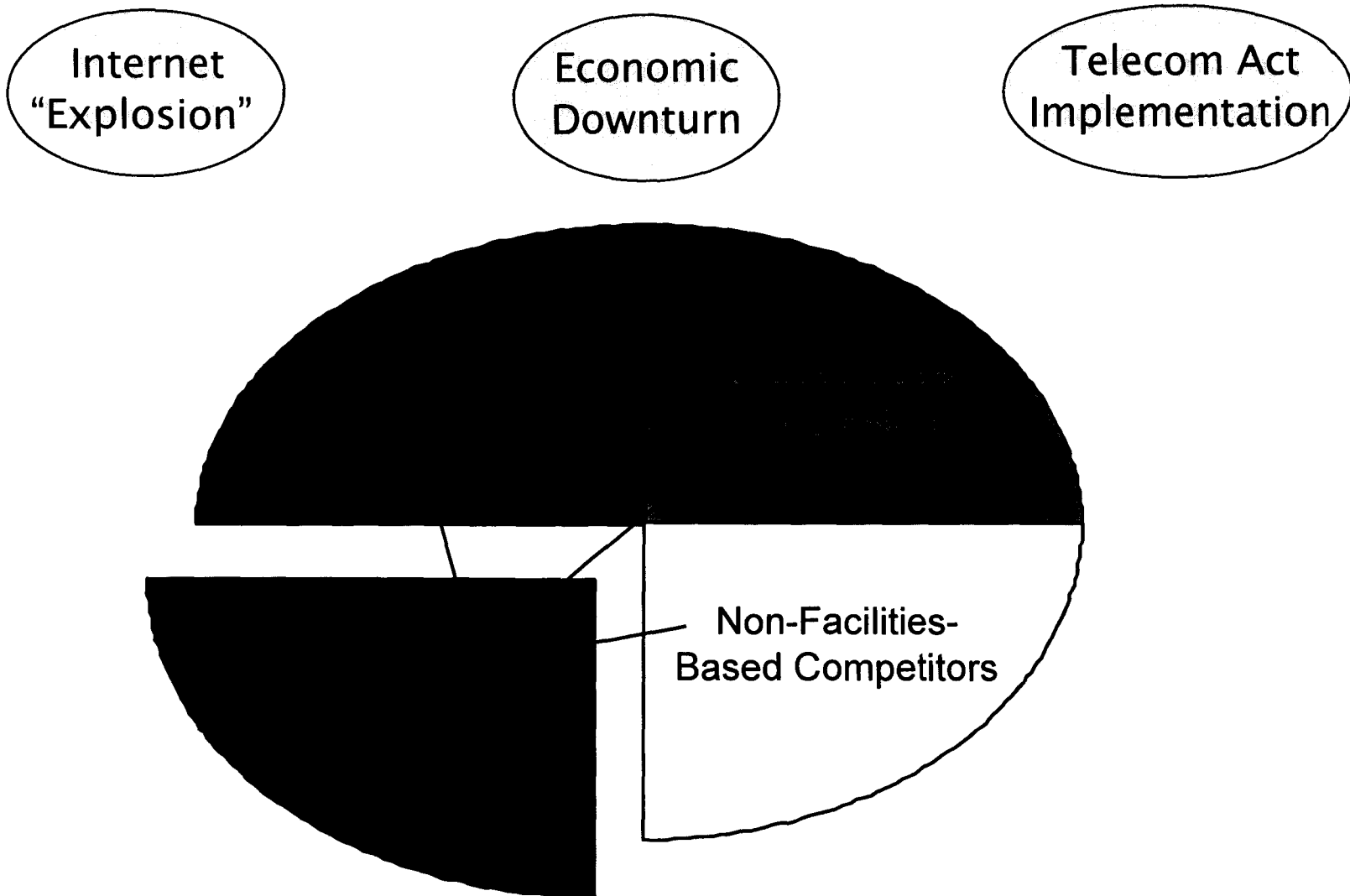
BellSouth Internal Labor – Wireline Only

Last 12 Months: -7,312 (-10.2%)
Projected 2002: 2,881 Additional



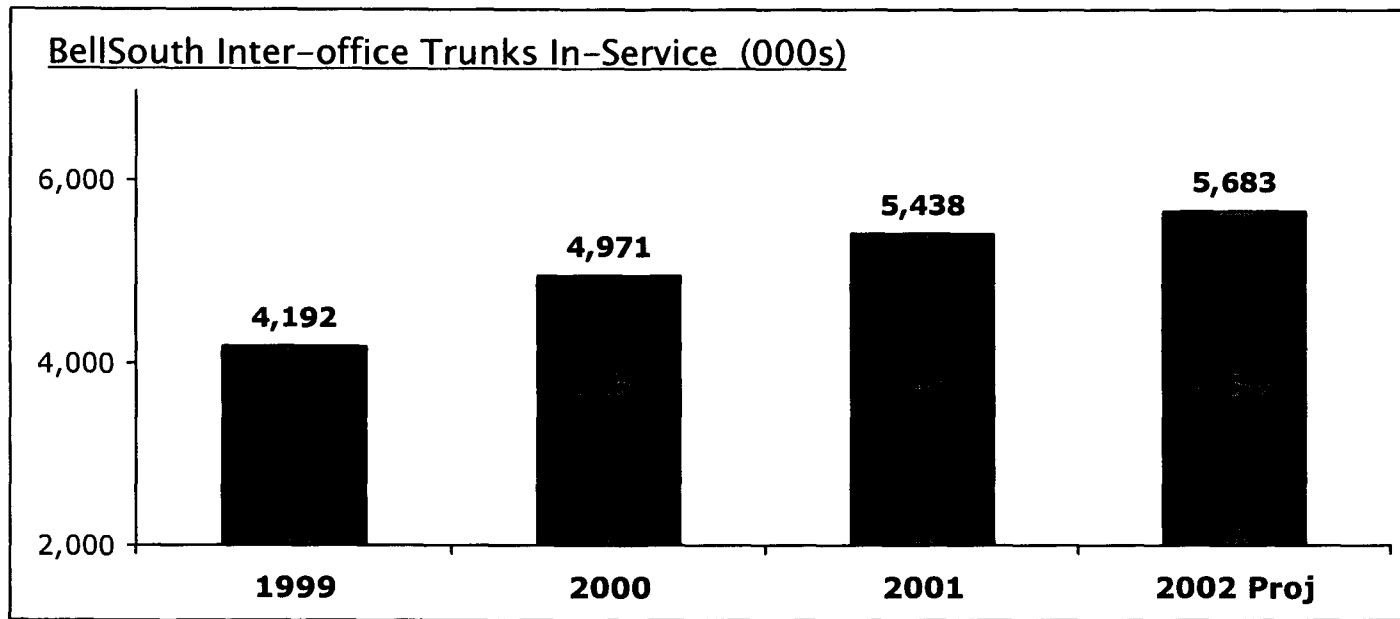
What Happened?

- The massive excess capacity within the Telecom industry was the result of three contributing dynamics all of which put tremendous financial pressure on the ILECs.



Internet "Explosion"

- **Although Internet growth did not meet publicized expectations, the annual doubling of Internet traffic dramatically increased the permanent cost of maintaining the PSTN.**
 - Flat-rate Internet pricing, enabled by the exemption of Internet traffic from per-minute access charges, increased the design requirements for the PSTN by adding longer call duration traffic to the network. The call duration of dial Internet access traffic is estimated to be six times longer than traditional voice traffic.
 - As a result, the combination of CLEC and Internet growth substantially increased ILEC inter-office trunk requirements. The ILECs earned virtually no incremental revenue on this incremental investment.



Economic Downturn

- **While not the cause of the Telecom industry implosion, the economic downturn exposed systemic industry issues sooner, creating an environment where businesses are retrenching and Carriers are grooming their networks.**

- **In-region business bankruptcies have substantially increased in 2002. In BellSouth's Large Business market, new voice access line connections have declined 47% in the first half of 2002 relative to the same period in 2001.**

- **In BellSouth's Carrier market, growth in hi-cap services (a \$1.1B revenue stream in 2001) has declined from 33 % growth in the first half of 2001 to -2.5% in the same period of 2002.**

- **The growth rate in total BellSouth wireline Data revenues (a \$4B revenue stream in 2001) has declined from 24 % in 2001 to only 6% in the second quarter of 2002.**

- **The downturn in the Internet market has driven a 25%, or \$100 million, decline in BellSouth's revenues from Internet Service Providers (ISPs) in 2002.**

- **Net bad debt has increased across all segments of the wireline business. Year-to-date, BellSouth's uncollectibles expense is 80%, or \$127 million, higher than 2001.**

Telecom Act Implementation

- **We believe one intent of the Telecom Act was to provide for an efficient wholesale market promoting long-term, sustainable economic competition. From a practical standpoint, certain aspects of the way the Telecom Act was implemented undermined the economics of the Telecom industry by creating a rules-intensive, enhanced price regulation model which serves simply to redistribute market share (and shareholder value).**

■ Issues fall into three broad buckets:

- » **Over Stimulated Competitive Entry** that has resulted in too many companies chasing too few revenue dollars.
- » **Additional Operating/Financial Requirements** that drive up fixed costs by dictating unnecessary granularity with respect to UNEs as well as complicated interconnection arrangements.
- » **Uneconomic Rules** related to network unbundling have destroyed value in the facility-based carriers and discouraged investment and innovation.

Telecom Act Implementation: Over Stimulated Competitive Entry

- The Telecom industry has demonstrated that heavy debt does not mix well with anemic growth – over 80 companies have filed for bankruptcy protection since January 2000.

Ten Largest Bankruptcy Filings in Telecom (\$ bn)

Company	Date	Assets	Company	Date	Assets
1 WorldCom	7/21/02	\$107.0	6 Metromedia Fiber Network	5/20/02	\$7.0
2 Global Crossing	1/28/02	25.5	7 360Networks	6/28/01	6.3
3 Adelphia Communications	6/25/02	24.4	8 Exodus Communications	9/26/01	6.0
4 NTL	5/8/02	16.8	9 Williams Communications	4/22/02	6.0
5 XO Communications	6/17/02	9.1	10 McLeodUSA	1/30/02	4.8

Other Bankruptcies

Company	Date	Company	Date	Company	Date	Company	Date
Adelphia Business Solutions	3/27/02	FLAG Telecom Holdings	4/12/02	Mpower Holding	4/8/02	SSE Telecom	5/17/01
Adesta Communications	11/2/01	FutureOne	3/29/01	NEON Communications	6/25/02	Star Telecommunications	3/13/01
Advanced Radio Telecom	4/20/01	General Datacomm Industries	11/2/01	Net2000 Communications	11/16/01	StarBand Communications	5/31/02
Advanced Telcom Group	5/2/02	Global Telesystems	11/14/01	NetVoice Technologies	10/17/01	Startec Global Communications	12/14/01
Ahead Communications Systems	2/7/02	Globalstar	2/15/02	Network Plus	2/4/02	Telecom Consultants	2/23/01
American Metrocomm	8/16/00	Grapes Communications	4/16/02	NorthPoint Communications	1/16/01	Teleglobe Holdings	5/15/02
Anicom	1/5/01	GRG	8/7/01	Novo Networks	7/30/01	Teligent Communications	5/21/01
Arch Wireless	12/6/01	GST Telecommunications	5/17/00	Orbcomm Global	9/15/00	Telscape International	4/27/01
At Home Corp. (Excite@Home)	9/29/01	iBEAM Broadcasting	10/11/01	Pacific Gateway Exchange	12/29/00	U.S. Wireless	8/29/01
Birch Telecom	7/29/02	ICG Communications	11/14/00	Paging Network (PageNet)	7/24/00	Ursus Telecom	4/6/01
BroadLink Wireless	6/25/02	IMPSAT Fiber Networks	6/11/02	Pathnet Telecommunications	4/2/01	Verado Holdings	2/15/02
Century Communications	6/10/02	Information Management Associates	7/24/00	Pensat	10/9/01	Versatel Telecom International	6/19/02
Clarity Telecommunications Int'l	4/18/02	International FiberCom	2/13/02	Pinnacle Holdings	5/21/02	Viatei	5/2/01
Convergent Communications	4/19/01	ITC DeltaCom	6/25/02	Pliant Systems	5/1/01	Wavve Telecommunications	8/15/01
Covad Communications	8/15/01	Lernout & Hauspie Speech Products	11/29/00	PNI Technologies	6/8/01	WebLink Wireless	5/23/01
Digital Broadband Communications	12/27/00	Let's Talk Cellular & Wireless	5/30/00	PNV	12/20/00	Western Integrated Networks (WINfirst)	3/11/02
DTI Holdings	12/31/01	Log on America	7/12/02	PSINet	5/31/01	Winstar Communications	4/18/01
e.spire Communications	3/22/01	Logix Communications Enterprises	2/28/02	qServe Communications	6/21/02	World Access	4/24/01
eGlobe	4/18/01	MarchFirst	4/30/01	Rhythms NetConnections	8/1/01	Yipes Communications	3/21/02
EqualNet Communications	8/9/00	Metrolcall	6/3/02	RSL Communications	3/19/01	ZeroPlus.com	2/14/02

Source: Bloomberg, Thomson Financial, BankruptcyData.Com.

1. Excluding private companies and companies with pre-bankruptcy assets under \$100 mm.

Telecom Act Implementation: Over Stimulated Competitive Entry

- **"Bankruptcy law effectively rewards and subsidizes market failure by deleting debt and allowing capacity to come back at irrational prices that solvent companies structures cannot match." [Precursor Group, 6/21/02]**

	<u>Before</u>	<u>After</u>	<u>% Change</u>
<u>Covad</u> <i>Filed: Aug-01 Emerged: Dec-01</i>			
Total Indebtedness:	\$1,338M	\$50M	-96 %
Annual Interest Expense:	\$150M	\$6M	-96 %
Cash and Investments:	\$295M	\$167M	-43 %
<u>ITC-Deltacom</u> <i>Filed: Aug-01 Emerged: TBD</i>			
Total Indebtedness:	\$724M	\$194M	-73 %
Annual Interest Expense:	\$60M	\$12M	-80 %
Cash and Investments:	\$23M	NAV	

...Not surprisingly, the growth in wholesale access has shown little evidence of this financial turmoil as few competitors have discontinued, or even slowed, operations while in bankruptcy...

Telecom Act Implementation: Additional Operating/Financial Requirements

- **The implementation of the act has also dictated costly, complex and cumbersome operating requirements further pressuring BellSouth's fixed cost structure.**

- **Reciprocal Compensation – From 1997-2001, we paid out \$239 million more than we received.**

- **Developed operating systems for 92 UNE product groups – Ten account for 90% of UNE revenue.**

- **Service Standards - BellSouth has spent \$135 million building a tracking system to report over 2,300 unique measurements each month.**

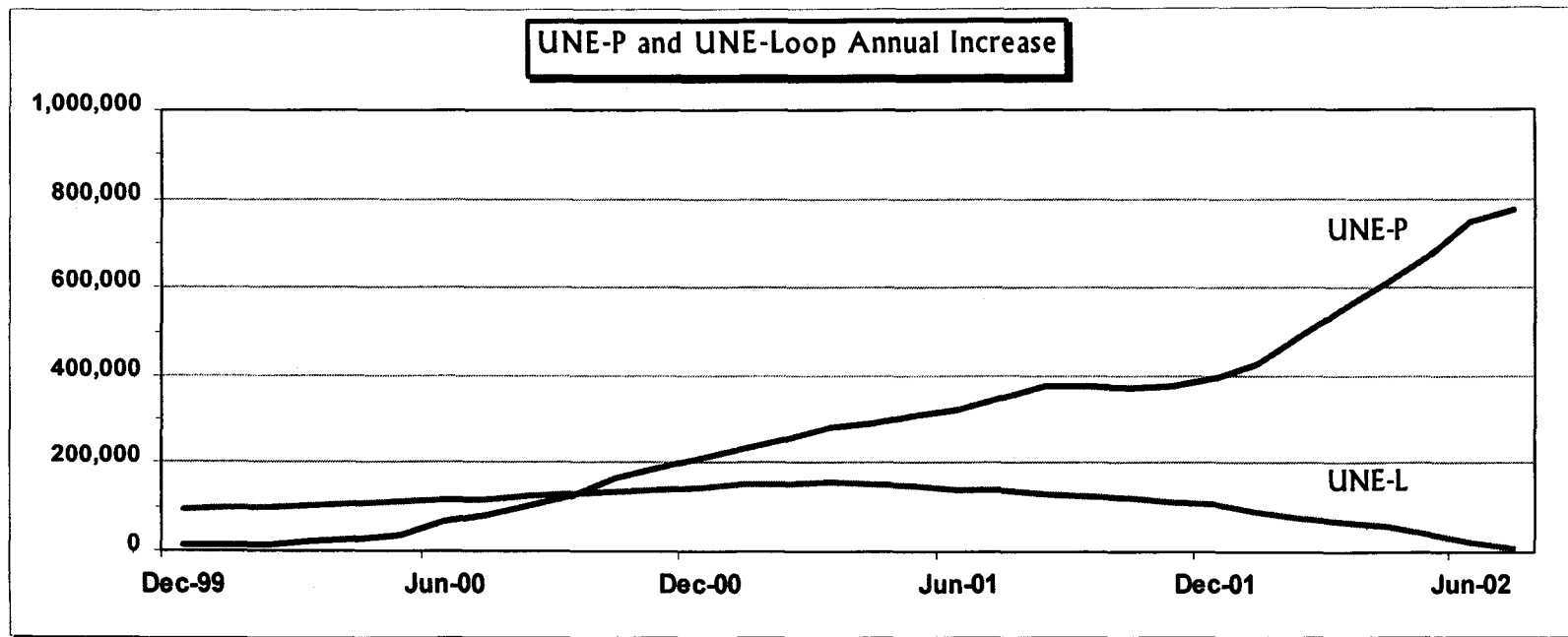
- **SEEMS – Paid \$42 million in 2001 and \$23 million so far in 2002.**

- **Co-location – Massive over ordering during internet boom caused BellSouth to deploy approximately \$400 million in capital followed by significant disconnects, bankruptcies and abandonments.**

Telecom Act Implementation: Uneconomic Rules

- The Act requires ILECs to unbundle loops and switching in order to allow CLECs the flexibility to recombine elements with their own networks. (We believe this requirement was intended to lower barriers to entry and encourage facilities-based competition.)

... In practice, rather than encouraging investment and innovation, non-facilities-based competitors have used UNE-P as an alternative to facilities deployment. In fact, 56% of the 354 active CLECs in BellSouth's region rely solely on BellSouth's network and UNE-Loop demand has all but disappeared.



... Competitors have increasingly relied on UNE-P as an “end” rather than as a “means” to develop a competitive facilities-based telecom business...

Telecom Act Implementation: Uneconomic Rules

UNE pricing has been the primary mechanism to accomplish this competitive “end” as competition was introduced by imposing a hypothetical cost-based wholesale rate structure into a historical social goal-based retail rate structure...

Actual Monthly BellSouth Service Rates (as of 8/15/02)

Subsidized

	Metro	Rural	Metro	Rural
AL	16	15	36	36
FL	11	7	30	20
GA	17	12	48	25
KY	18	14	33	35
LA	13	11	33	29
MS	19	15	37	35
NC	13	10	34	28
SC	15	13	43	33
TN	12	8	40	27

Hypothetical Cost

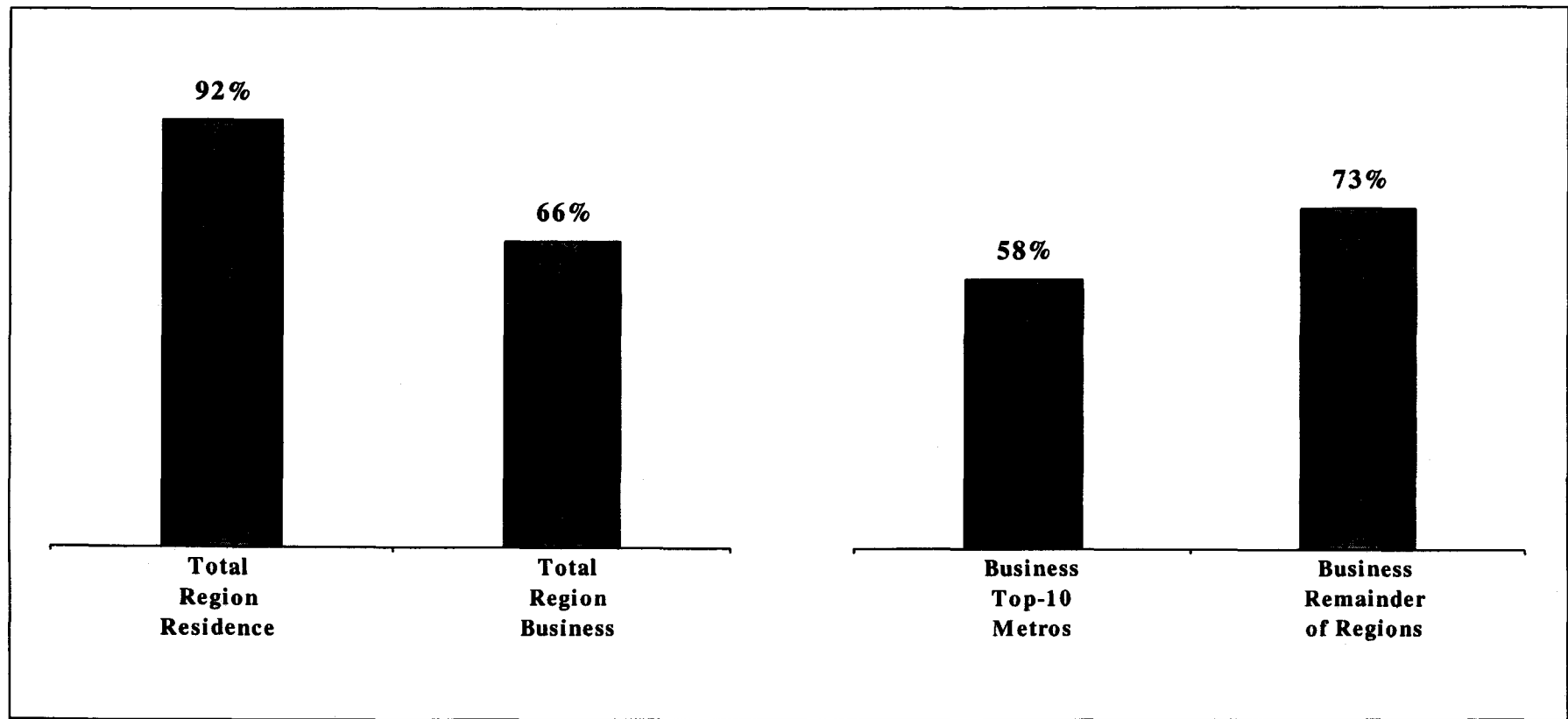
Metro	Rural	Metro	Rural
13	34	16	38
13	33	16	35
14	26	17	26
11	31	14	35
13	48	18	55
12	44	16	49
12	34	17	37
15	27	19	31
13	23	17	26

... placing ILECs at a significant competitive disadvantage in that they bear the entire framework of subsidies built into their rates (where margins are richer in business than residence, and in urban than rural), allowing CLECs to cream-skim the highest value customers ...

Telecom Act Implementation: Uneconomic Rules

- ... The pattern of cream-skimming is evident in BellSouth's market share activity ...

% BellSouth Retail Market Share



Telecom Act Implementation: Uneconomic Rules

- ... In addition, ILECs are required to sell services at UNE-P pricing in areas where facilities-based competition is flourishing. The presence of alternative facilities dispels any notion of impairment.

Alternative Facilities at Market Rates				TELRIC Facilities (07/31/02)		
	Instances of Non-BST Entrance Facilities From CLEC Networks ¹	Numbers Ported to CLEC Facilities ²	Percent of BellSouth Lines Addressed by more than three CLEC Switches ²	Business UNE-P	Residence UNE-P	UNE-L
BellSouth MSAs in National Top 50 ³	498	1,240,781	95% Bus 90% Res	158,010	332,171	186,736
BellSouth MSAs in National 51-100 ⁴	273	601,955	90% Bus 84% Res	122,348	79,124	97,760

¹ Entrance facilities are gateways into CLEC networks. Data as of February, 2002

² Source: NERA Reply Comments in Triennial Review

³ Includes Atlanta, Greensboro-Winston Salem-High Point, Charlotte-Gastonia, Miami-Ft. Lauderdale-Hollywood, Nashville-Davidson, New Orleans and Orlando

⁴ Includes W. Palm-Boca Raton, Baton Rouge, Raleigh-Derham, Columbia, Memphis, Greenville-Spartanburg, Jacksonville, Knoxville, Louisville and Mobile

Telecom Act Implementation: Uneconomic Rules

...In the end, UNE-P is *highly deflationary* to the industry.

From a macroeconomic point of view, UNE-P represents a policy-stimulated transfer of wealth (from facilities-based carriers' shareholders and employees to UNE-P CLEC's) that devalues the investments of all facilities-based providers and offers no improved value to the customer.

Summation

- BellSouth is not “de-regulated”, but finds itself in a “market environment”.
 - » Revenue growth is declining precipitously
 - » Cost requirements remain relatively fixed
 - » Earnings are being driven down.

- With the need for access to capital as great today as ever, investors are avoiding the sector.

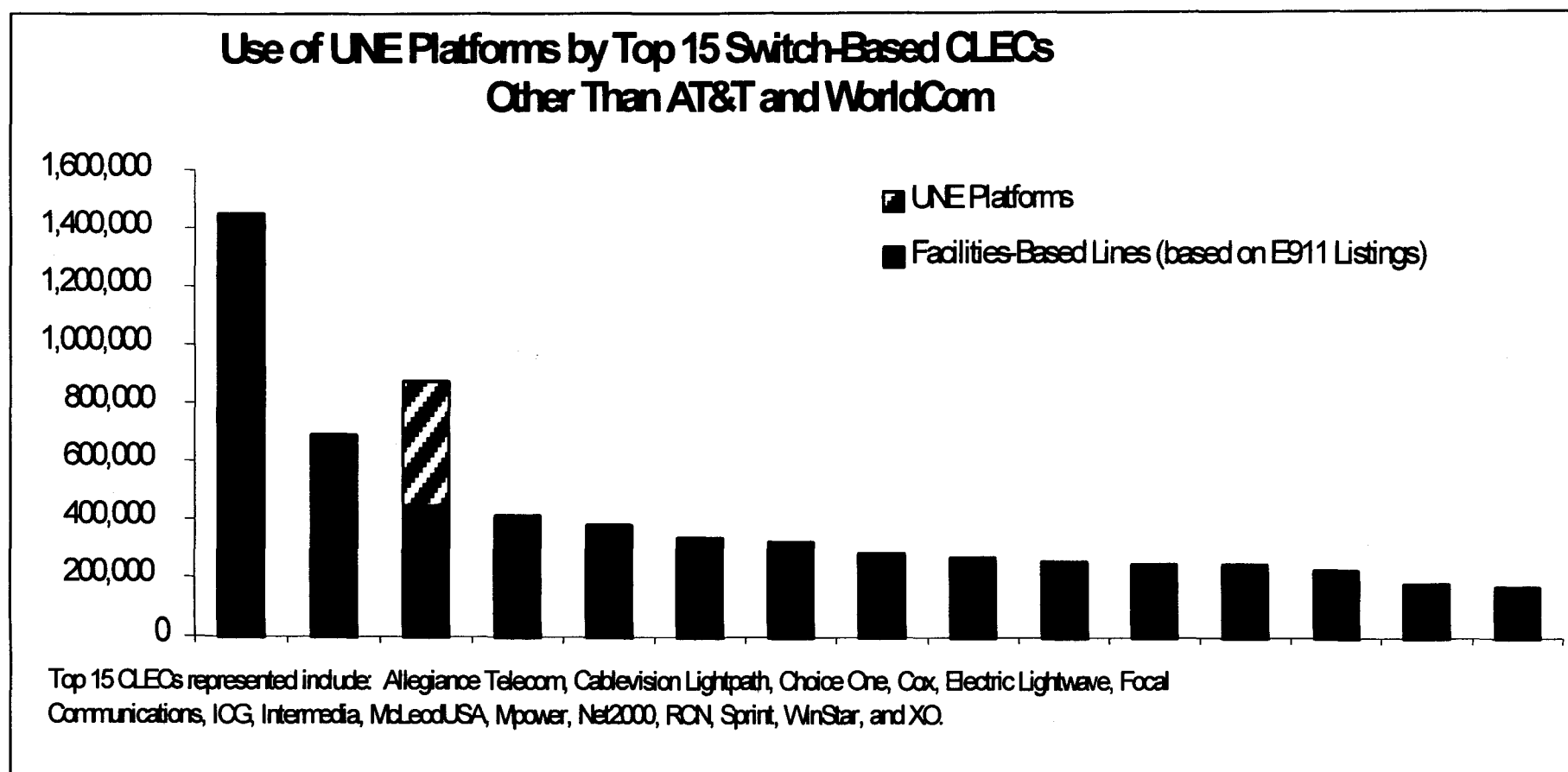
...there are a number of forces at work today in the telecom industry that market participants cannot avoid. But there are also some man-made forces that pose grave, immediate threats to our vitality that must be addressed ...

Proposed Solutions

- FCC can help stabilize network economics by:
 - Limiting the number of UNEs available at TELRIC, especially switching and transport
 - Act quickly on Triennial review
 - Adopt policies that encourage investment
 - Broadband NPRM
 - TimeWarner/BellSouth framework
 - Adopt policies that reward sound financial management
 - Approve deposit tariffs
 - Avoid actions that reward bankruptcy and fraud

Proposed Solutions

- Other than AT&T and WorldCom, the 15 largest CLECs that have deployed switches make virtually no use of UNE-P



Source: Based on E911 listings

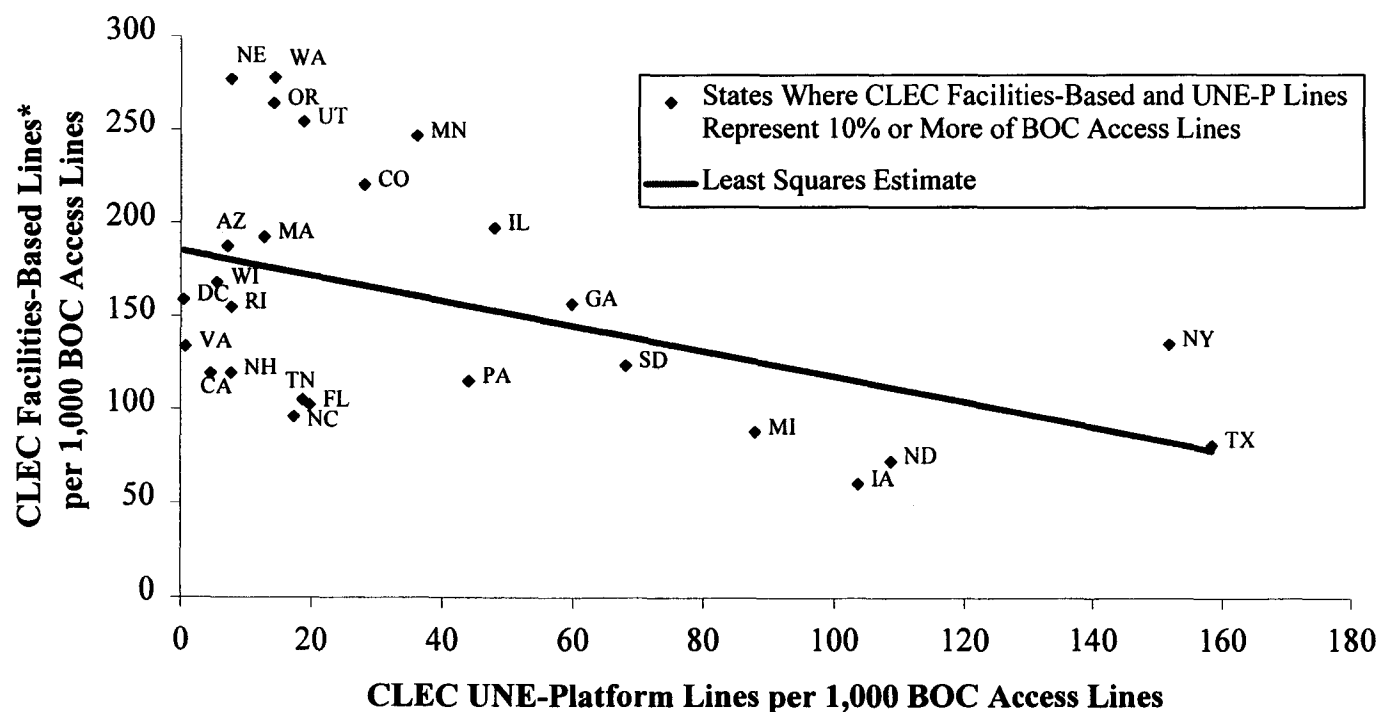
Fact Report reference: p. I-9

Proposed Solutions

The Availability of UNE P Decreases the Level of Facilities-Based Competition

- Data from all states with significant CLEC entry demonstrate that the availability of the UNE-P decreases the level of facilities-based competition.

Figure 1. Facilities-Based Competition Decreases as UNE-P Penetration Increases



*Facilities-based lines are based on CLEC E911 listings as of year-end 2001.

Proposed Solutions

Proposed Solution – Eliminate UNE-P Telric

- In New York, AT&T and WorldCom together provide UNE-P service to over 1M residential customers
- AT&T and WorldCom operate 28 local circuit switches in New York
- Yet the two companies have converted virtually none of these UNE-P customers to service utilizing their own switches
- Arbitrage opportunities are too rich to encourage new investment or even use of existing investment

Fact Report reference: pp. 11-18-19

Proposed Solution

- **While UNE-P does nothing to create sustained investment in Competitive networks, it does create huge concerns about the financial viability of the ILEC.**

Recent Analysts comments:

Deresdener Kleinworth Wassatein*

“From an macroeconomic point of view there are general concerns with the UNE-P system:

- It’s a policy-stimulated transfer of wealth (from shareholders and employees to consumers), rather than being left to market forces.
- In the longer-term it could rob consumers of advanced services that require the RBOC’s plentiful cash flow to fund.
- Asset write-downs will cause “stock-shock” and a shock to the telecom “supplier system.”

* UNE-P: The Un-Profitable RBOC (August 9, 2002)

Proposed Solution

Recent Analysts comments: (continued)

UBS Warburg*

“Economics of UNE-P are Worse than we Originally Expected.

- UNE-P lines generate negative EBITDA in 18 States for the Bells (60% of US residential lines)

- Long Distance Opportunity is only a Partial Offset
 - Bells only need to add 1.3 Long Distance Customers for each UNE-P line added to break even at revenue line.
 - However, the Bells need to add 5.4 Long Distance Customers for each UNE-P line added to break even at EBITDA line.
 - “UNE-P IS AN EBITDA STORY, NOT A REVENUE STORY”

Solomon Smith Barney**

- “From a Bell perspective, as we’ve written many times over the past several months, this is a nightmare. They get half the revenue with the same cost.”

* The Regional Bells: How Much Pain from UNE-P

** SBC Communications Report (July 23, 2002)

Proposed Solution

Recent Analysts comments: (continued)

Commerce Capital Markets*

- “For the CLECs, the lower UNE rates present the opportunity to enter the local market with minimal up-front investment.
- From the RBOC – investor’s perspective UNEP presents several problems. One is the reduction in revenues that comes from converting retail to wholesale revenues. The other is the pricing compression that comes from the RBOC’s an attempt to restructure their prices to compete with new entrants. Finally, there is the exposure during a period when an RBOC cannot yet enter long-distance, but the IXC’s have begun to enter its local market.”

Percursor Group*

- “There is a “telecom debt spiral” where over-capacity is not getting worked out of the system, but comes back less leveraged and on competitive steroids. The trends toward data and wireless present profit-challenged growth; and regulator-priced “competition” continues to deflate profits.”

* The States of 271 and UNE-Platform in the Regional Bell Territories (August 22, 2002)

** Percursor Investment Perspective (April 3, 2002)

Proposed Solution

Eliminate transport as UNE (unnecessary for competition) and continue special access protections.

Special Access Facts

- 1985 – Teleport Provides Transport Services for special access to business customers in NY
- 1986 – 16 States authorize special access competition
- 1995 – 29 CAPS serve 100 cities with 21K fiber route miles
- 2001 – 1800 networks serve 70% of US population, 150 largest MSAs. 91/100 top MSAs served by 3 networks, 77 by 7, 59 by > 10.

Source – UNE Fact Report 2002, p.K-1

Proposed Solutions

- FCC can help stabilize network economics by:
 - Limiting the number of UNEs available at TELRIC, especially switching and transport
 - Act quickly on Triennial review
 - Adopt policies that encourage investment
 - Broadband NPRM
 - TimeWarner/BellSouth framework
 - Adopt policies that reward sound financial management
 - Approve deposit tariffs
 - Avoid actions that reward bankruptcy and fraud

Back-Up

Class-of-Service specific and Market-based rates - No distinctions were allowed in the original FCC order with respect to the rates charged for similar services offered to different types of customer . This unfairly and uneconomically put the ILEC at a competitive disadvantage as ILEC residential and rural rates have been subsidized by PSC-mandated higher rates on urban and business customers. CLECs have exploited this inequity by reselling ILEC services (purchased a wholesale rates that do not bear the cost of subsidizing rural and residential service) to those customers and markets that bear the brunt of the subsidies. ILECs should be afforded the flexibility to charge market-based rates that minimize subsidies.

Impose sunset limits on UNE-P - UNE-P at TELRIC should have a “date certain” by which CLECs will have had time to overcome any impairment and economically build facilities of their own. Unbundled elements will still be available, but at market-based rates.

Restrict UNE-P to non-competitive areas - Consistent with the Supreme Court ruling that requires regulators to give more consideration to the availability of alternative facilities when deciding what, and where, facilities are to be unbundled, unbundled elements should only be available in areas where CLEC’s ability to offer service would be impaired without them. According to the Supreme Court: “... the Commission assumption that any increase in cost (or decrease in quality) imposed by denial of a network element renders access to that element ‘necessary’ and causes the failure to provide that element to ‘impair’ the entrant’s ability to furnish it’s desired services is simply not in accord with the ordinary and fair meaning of those terms.”

Continue “safe-harbor” local service restrictions - This refers to unbundled dedicated transport. IXC’s, CLEC’s, and CMRS carriers have tried to convert existing special access facilities, over which they are currently providing non-local services at a profit, to unbundled elements. This is simply a play to transfer hundreds of millions of dollars of wealth from ILECs to these carriers. The fact that they are currently profitable proves that impairment does not exist. Further, in most areas where these facilities exist in significant quantities, there are several non-ILEC providers of dedicated transport.

Move to “Bill and Keep” with respect to interconnection - This refers to requiring carriers to recover the call termination costs from their own customers rather than from the originating carrier. This could be done through a flat or usage-sensitive structure determined by the market.

Wholesale Reductions in Average Margin Per Line

Back-Up

- Dramatic declines in price relative to Retail, combined with little change in costs literally bleeds profitability out of the ILECs as CLECs cream-skim the most profitable customers.

Residence Migration	Retail	Resale	UNE Combo	UNE Loop	Bypass
Revenues					
Basic service	27.71	21.65	21.59	16.23	0.00
Features & Other Svcs	7.35	5.47	1.17	0.00	0.00
SWA/ LIC	5.52	5.52	0.07	0.00	0.00
Total	40.58	32.64	22.83	16.23	0.00
Expense					
Basic service	10.98	11.31	12.05	6.59	4.43
Features & Other Svcs	0.95	0.98	0.98	0.00	0.00
SWA/ LIC	2.34	2.34	0.59	0.00	0.00
Total	14.26	14.62	13.62	6.59	4.43
Product Contribution	26.32	18.02	9.21	9.64	(4.43)
Percent Change from Retail		-32%	-65%	-63%	-100%

Business Migration	Retail	Resale	UNE Combo	UNE Loop	Bypass
Revenues					
Basic service	51.40	43.57	24.76	16.23	0.00
Features & Other Svcs	10.35	5.47	1.17	0.00	0.00
SWA/ LIC	5.52	5.52	0.07	0.00	0.00
Total	67.28	54.56	26.00	16.23	0.00
Expense					
Basic service	8.63	8.84	7.96	6.59	4.43
Features & Other Svcs	0.89	0.98	0.98	0.00	0.00
SWA/ LIC	2.34	2.34	0.59	0.00	0.00
Total	11.86	12.15	9.53	6.59	4.43
Product Contribution	55.41	42.41	16.47	9.64	(4.43)
Percent Change from Retail		-23%	-70%	-83%	-100%

NOTE: Product expenses shown in these tables include only costs that are directly driven by the product. Product contributions must be sufficient to cover costs that are not product-specific, including all business overheads, and taxes. These non-product specific costs generally represent 45% of total corporate expenses.

Current State of BellSouth's Wireline Business – Cost Structure Back-Up

■ Let's Lay Out Our Cost Actions:

- » Eliminated x,xxx jobs
- » Voluntary Furlough
- » Cut Travel / Training
- » Cut Capital \$1.8 billion
- » Etc.
- » Only gave 2% raises
- » Cut bonuses

■ Meanwhile:

- » IT costs [↑]are up xx% due to increase of wholesale activity
- » SEEMS [↑]
- » Reciprocal Compensation [↑]
- » Independent Company Settlements
- » Bad Debt
- » Pension & Benefit Costs

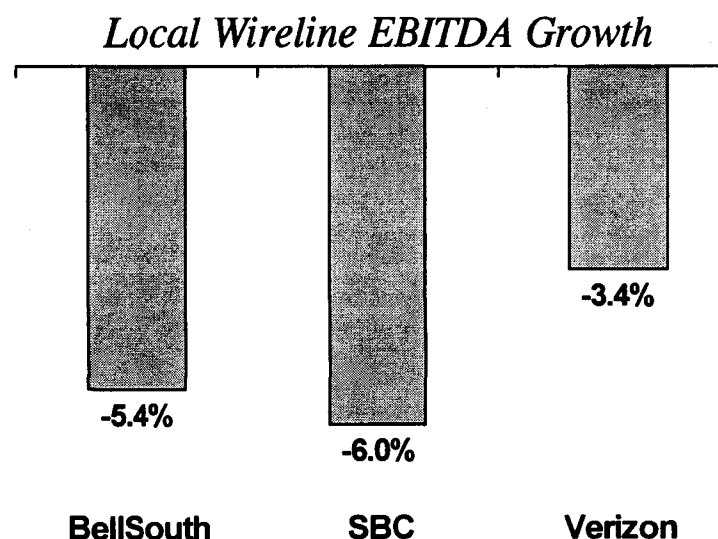
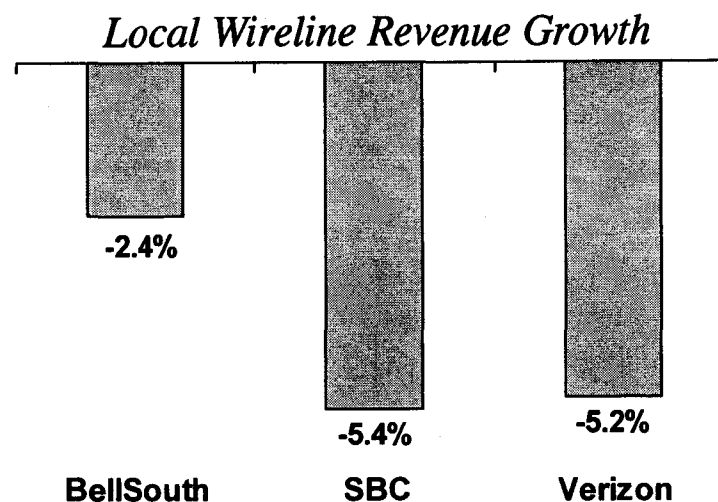
Second Quarter 2002 ILEC Highlights

Back-Up

- Second quarter 2002 results demonstrate that the issues facing BellSouth's business are common to the other ILECs.

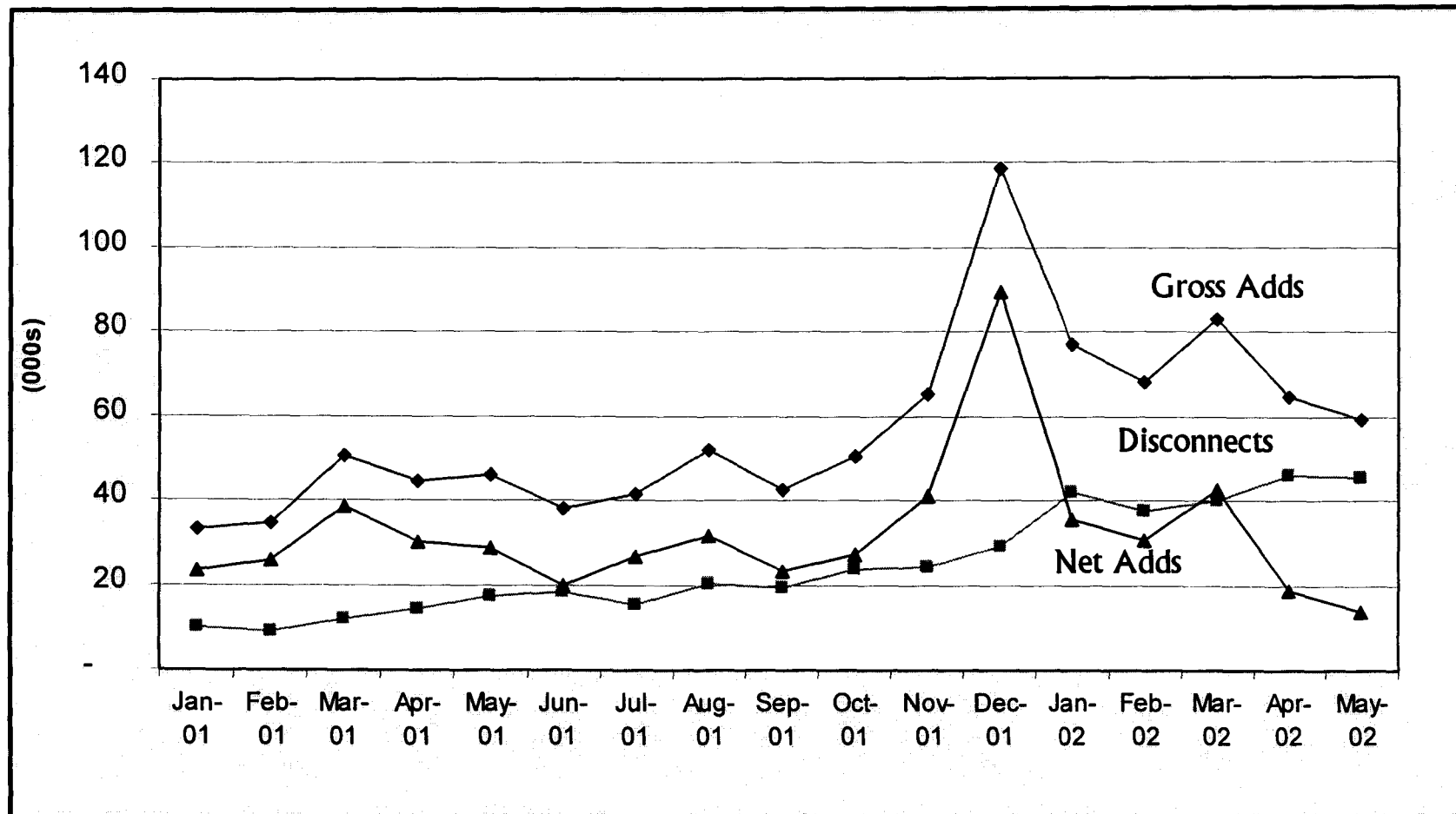
	BellSouth	SBC	Verizon
Data Growth*	6.0%	7.5%	7.5%
DSL Sec Qtr Subscriber Growth	10.3%	14.1%	11.1%
Access Line Growth	-2.1%	-3.8%	-3.3%
VGE Growth	13.8%	4.6%	7.9%
Access MOUs	-10.4%	-4.9%	-7.4%

Source: Company Reports



Current State of BellSouth's Wireline Business – New Products Back-Up

- By year-end 2002, BellSouth will have invested \$2.6 billion in Broadband deployment and provide coverage to 74% of in-region households. However, slowing subscriber growth coupled with monthly churn rates in excess of 5% provide evidence that the “early adopter” stage is complete.

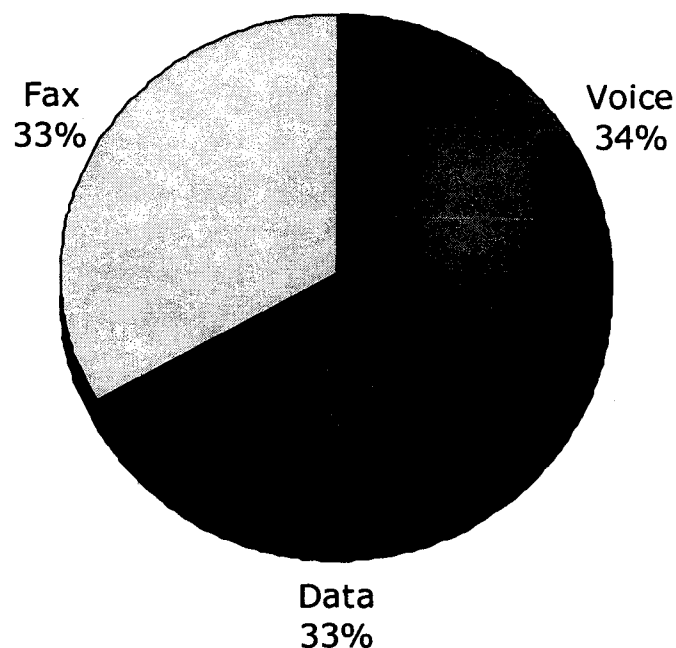


Wireless Competition and Broadband Substitution

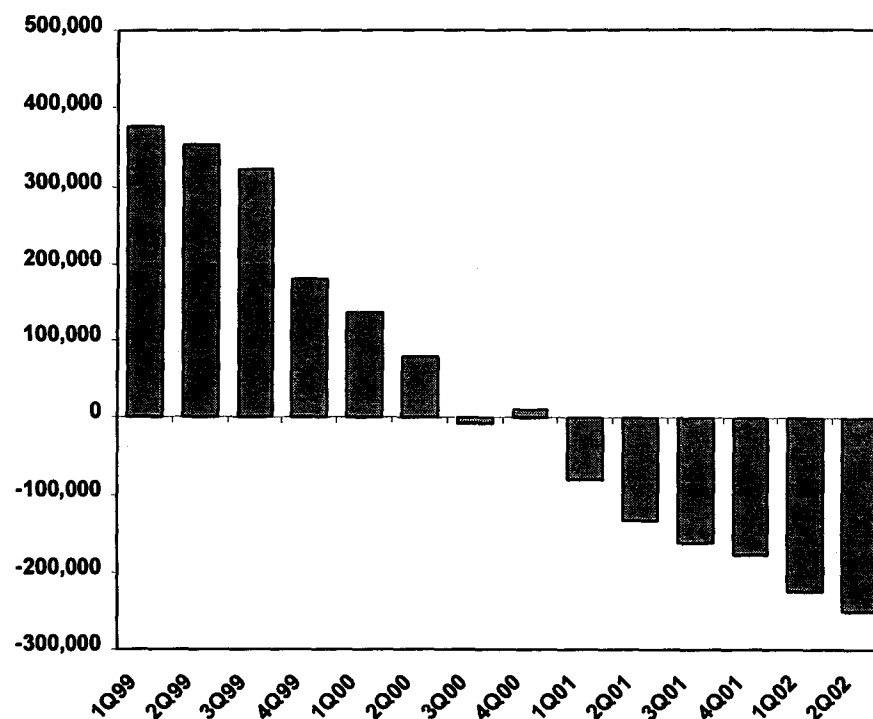
Back-Up

- Wireless competition and broadband substitution have had a dramatic impact on BellSouth's embedded residential additional line base as well as the Company's ability to drive further penetration. The result has been increasing excess capacity, further pressuring the fixed cost structure of the Company's distribution network.

Composition of BellSouth's 2.1 million Residential Additional Lines



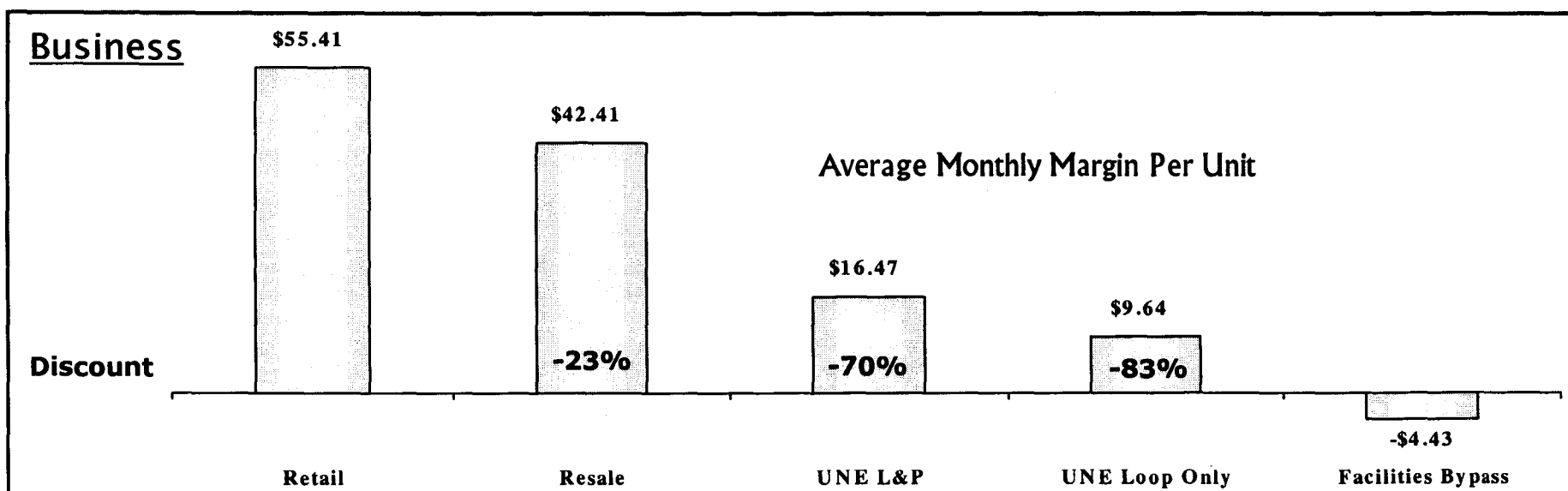
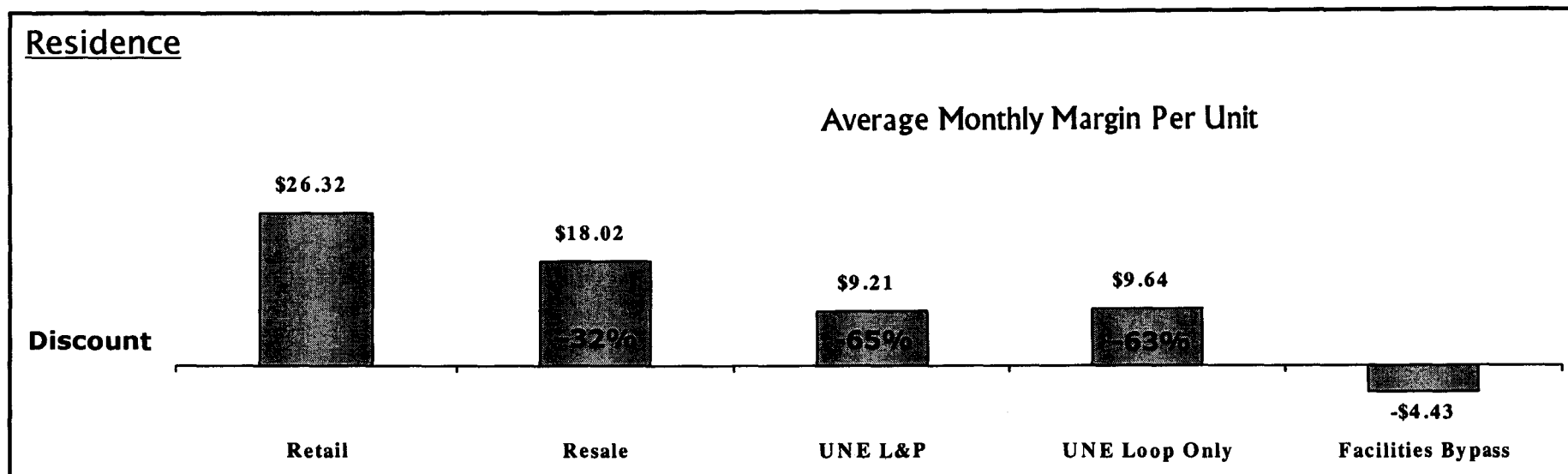
Quarterly Change in Additional Lines



Wholesale Reductions in Average Margin Per Line

Back-Up

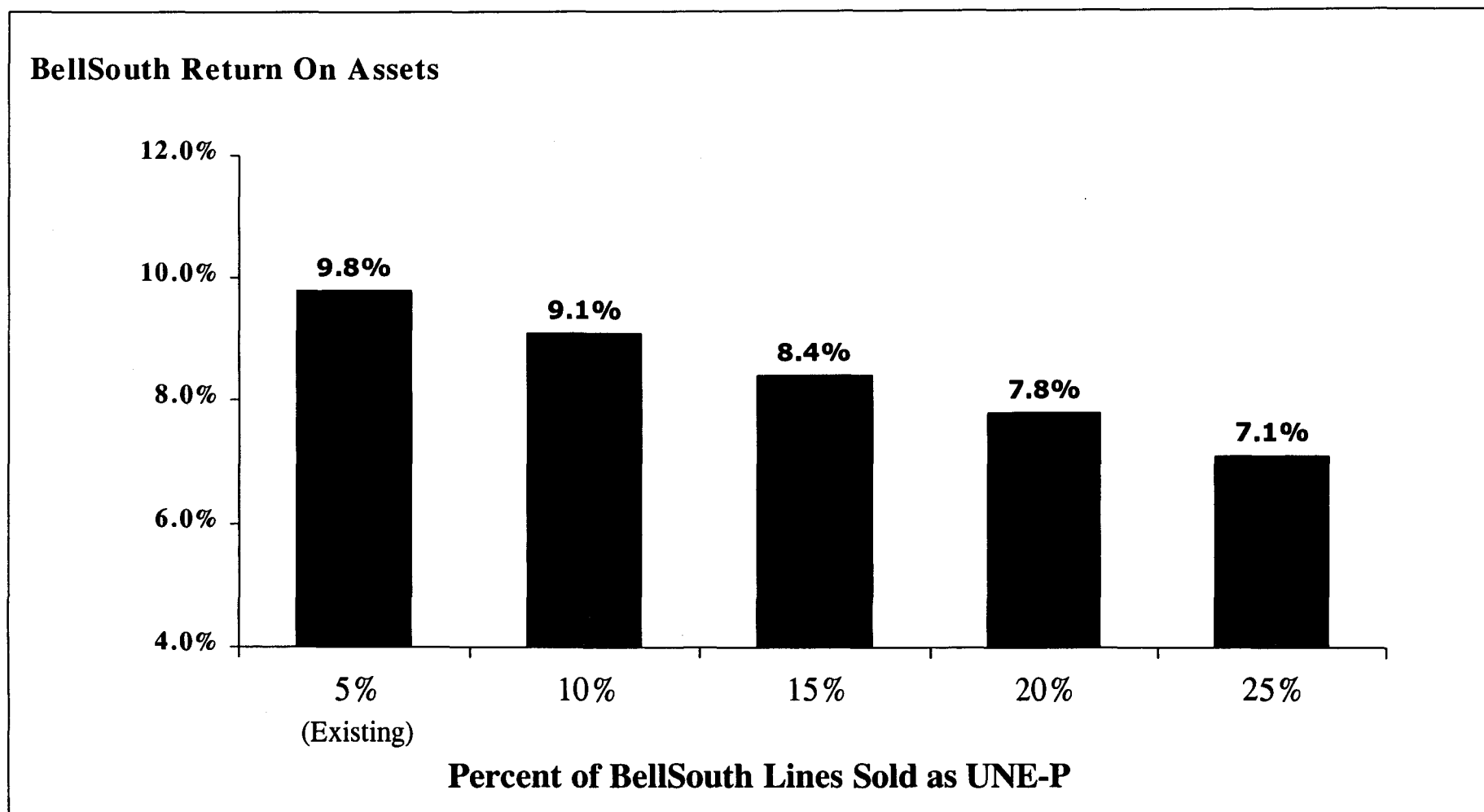
- On a regional basis, BellSouth's margins decline by 65% to 80% under UNE-P pricing relative to retail pricing.

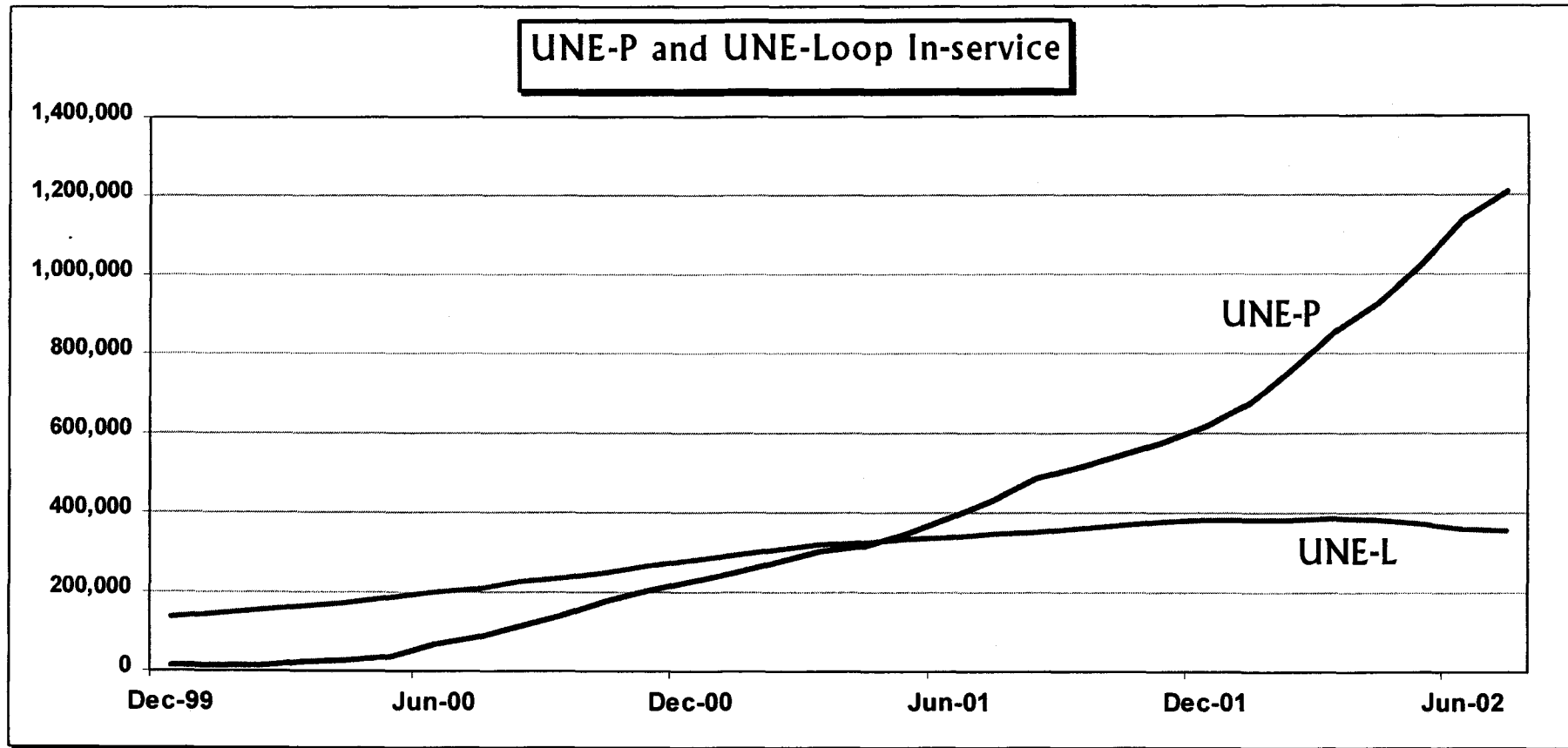


Impact of UNE-P Pricing on BellSouth Wireline Profitability

Back-Up

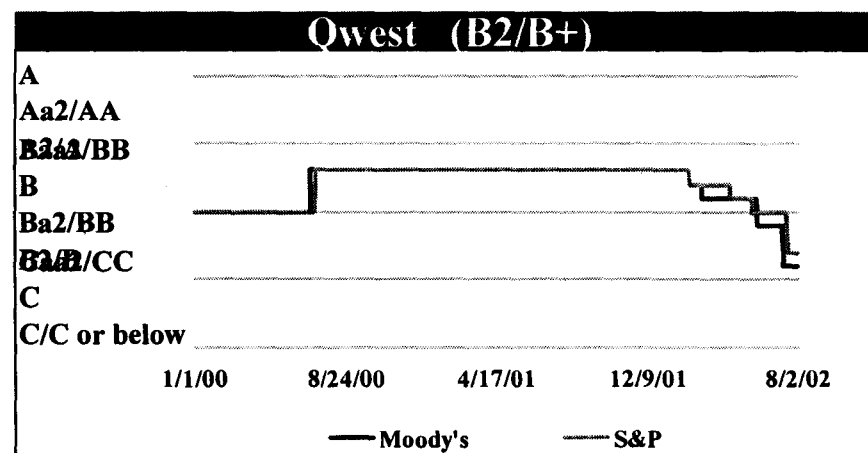
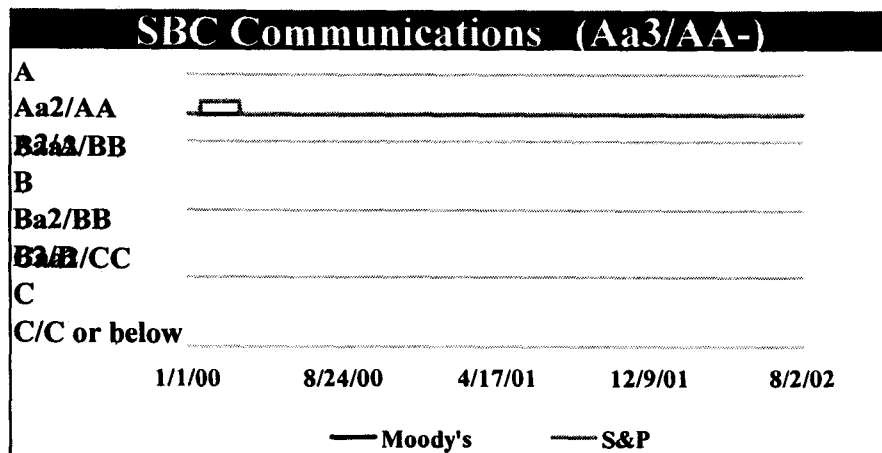
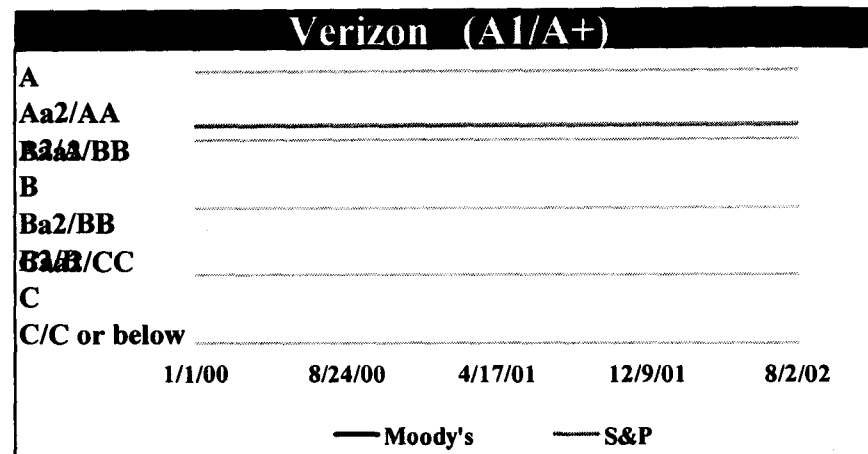
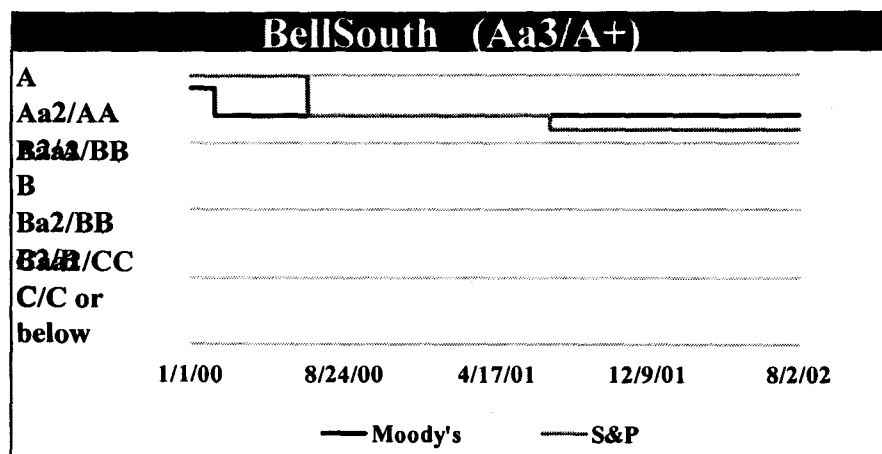
- **Based on existing Retail and UNE-P pricing, BellSouth's return on assets will decline by 28% when 25% of its access line base has migrated to the UNE-P platform.**





Six of the seven major domestic wireline telcos have experienced downgrades since 2000 U.S. Telecommunications Industry

◆ Qwest and WorldCom are currently the only two below investment grade

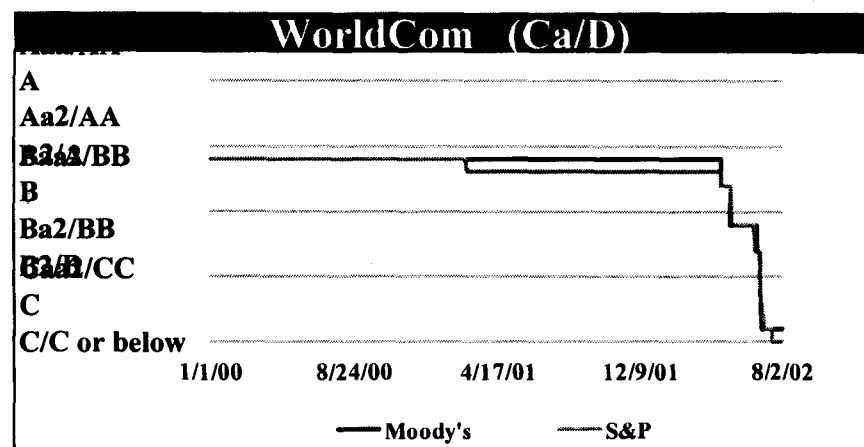
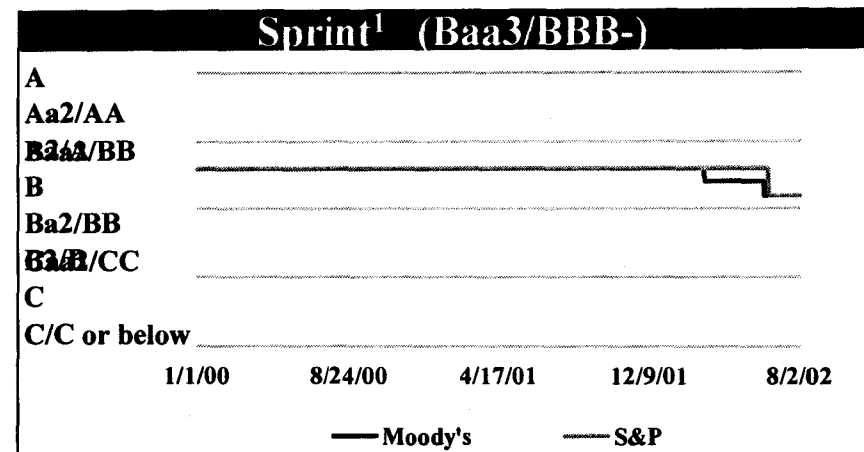
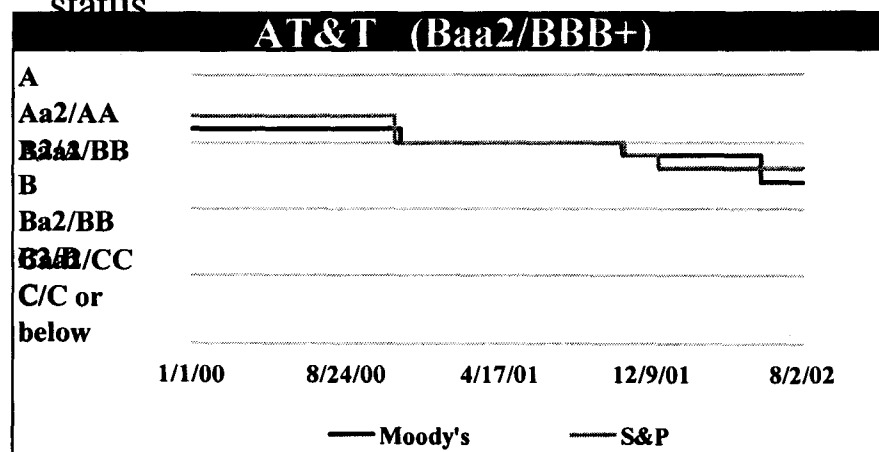


Note: Non-investment grade at Ba1/BB+ and below.

Long distance providers have been heavily impacted

U.S. Telecommunications Industry

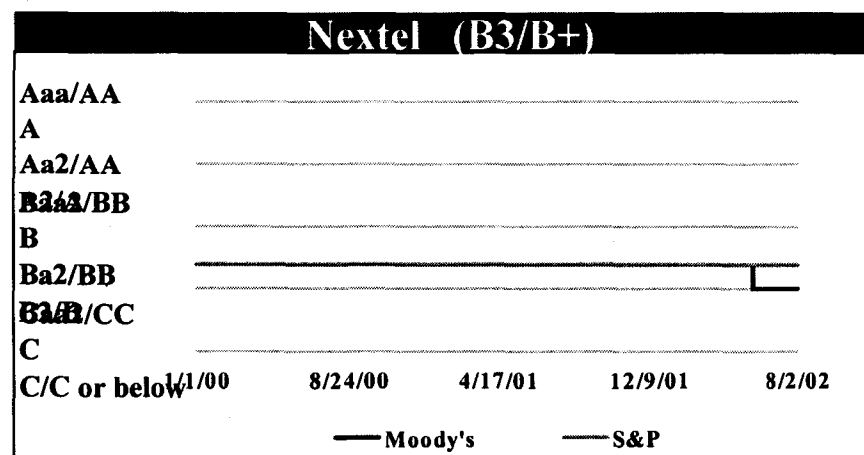
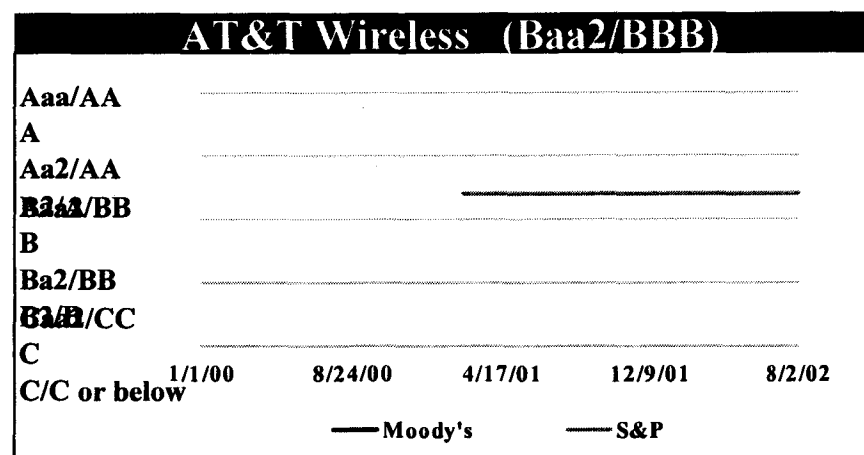
- ◆ WorldCom has filed for Chapter 11 bankruptcy protection
- ◆ Sprint (both agencies) and AT&T (Moody's only) are within two notches of non-investment grade status



Note: Non-investment grade at Ba1/BB+ and below.
1. Includes FON and PCS.

U.S. Telecommunications Industry

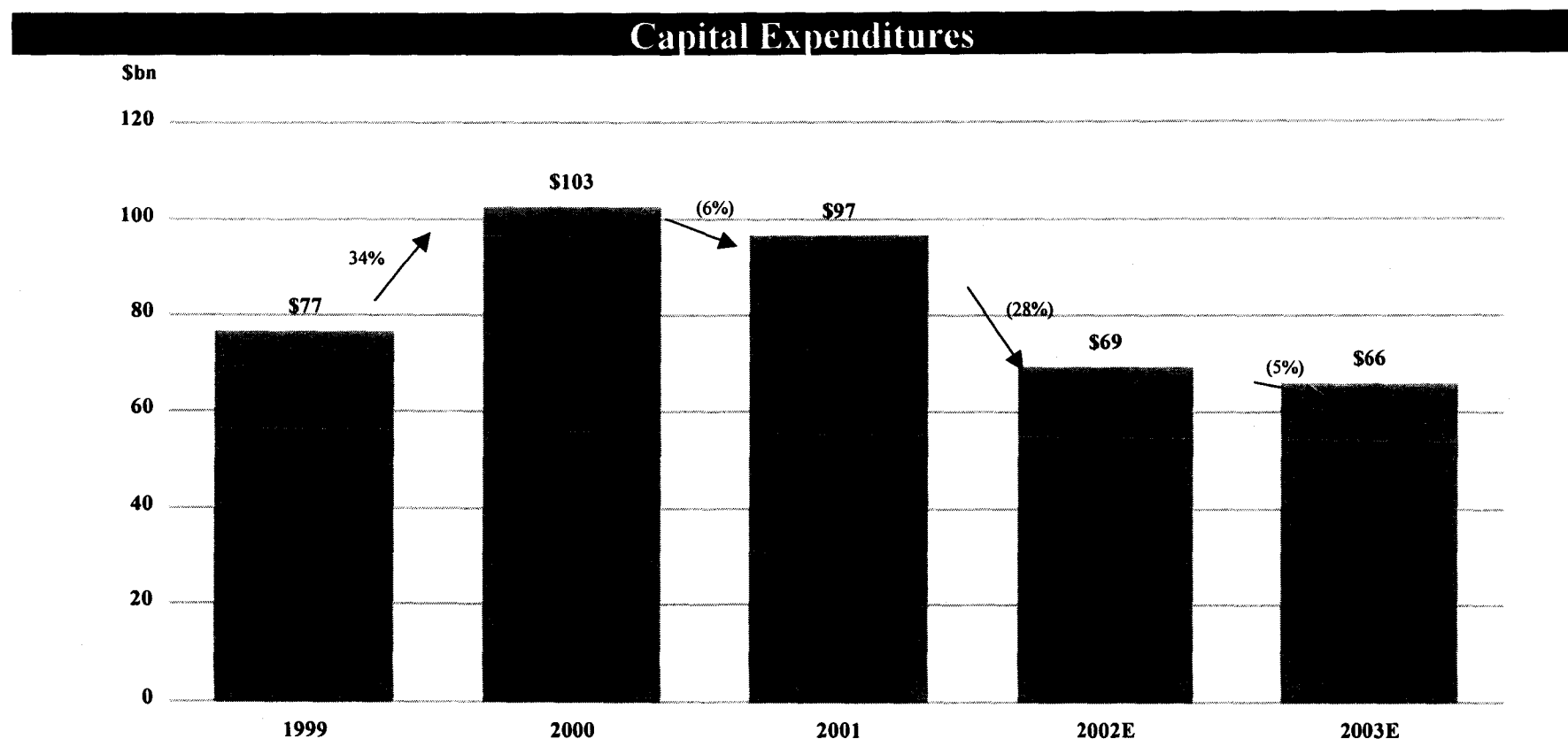
Of the two major publicly traded wireless telcos¹, Nextel is non-investment grade and AT&T Wireless is within two notches of non-investment grade status



Note: Non-investment grade at Ba1/BB+ and below.
 1. Excludes Sprint PCS which is a tracking stock of Sprint Corporation.

U.S. Telecommunications Industry

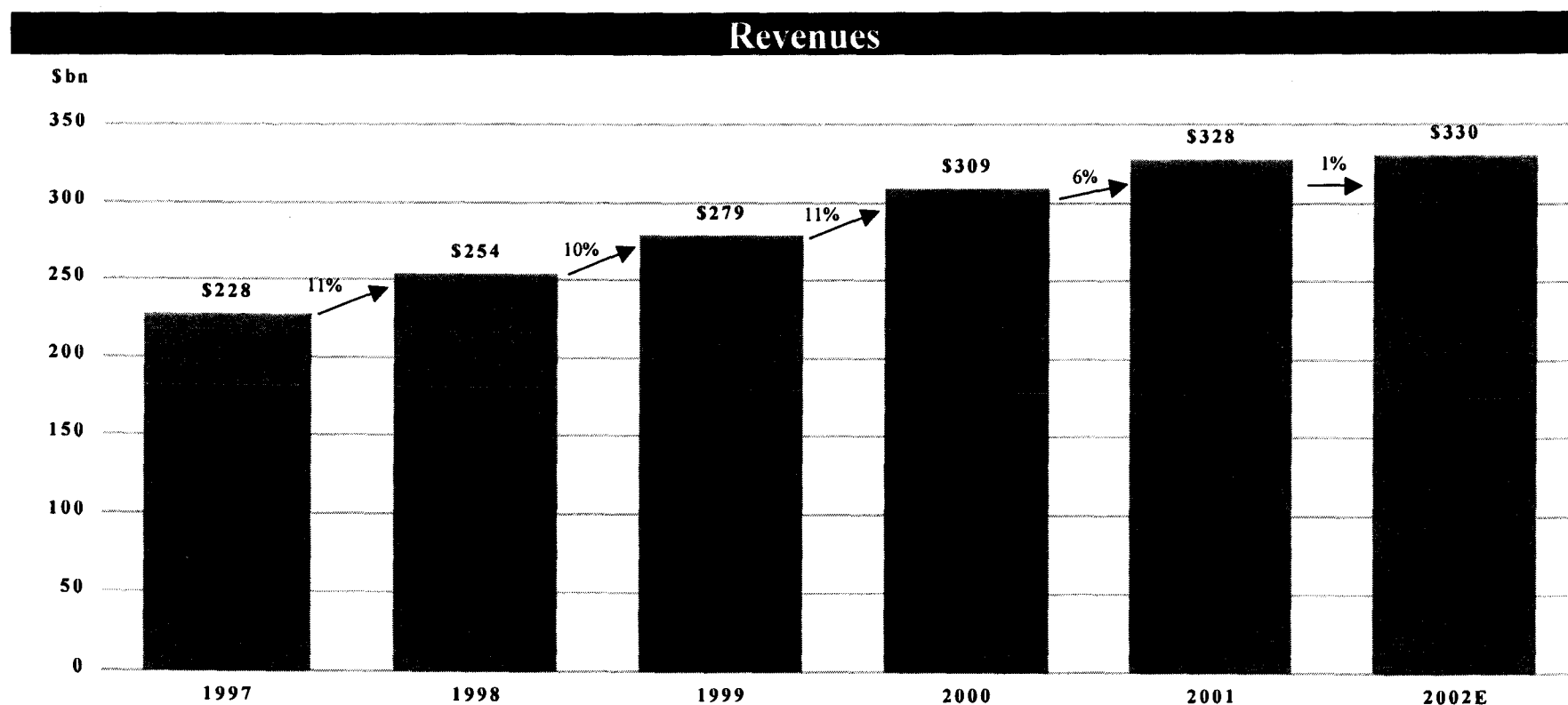
Industry-wide¹ annual capex declined 6% from 2000 to 2001 and is expected to decline an additional 28% in 2002 and 5% in 2003



Source: 1999-2002 figures based on Lehman Brothers Equity Research; 2003 figure based on Lehman Brothers estimate.
 1. Includes BellSouth, Verizon, SBC, Qwest, AT&T (excl. Broadband), Sprint FON, WorldCom, Cingular, Verizon Wireless, Sprint PCS, VoiceStream, Nextel, AT&T Wireless, Intermedia, McLeodUSA/SPLT, XO, Time Warner Telecom, Teligent, Choice One, Alegiance, WinStar, RCN, US LEC, Network Plus, CTC, Focal, Covad, CenturyTel, Alltel, Citizens, Level III, Williams Communications, and Global Crossing.

U.S. Telecommunications Industry

Industry-wide¹ year-on-year revenue growth has fallen from 11% in 1998 to -3% in the first quarter of 2002



Source: Based on Lehman Brothers Equity Research; 2002 first quarter figure based on Lehman Brothers estimate.

1. Includes BellSouth, Verizon, SBC, Qwest, AT&T (excl. Broadband), Sprint FON, WorldCom, Cingular, Verizon Wireless, Sprint PCS, VoiceStream, Nextel, AT&T Wireless, Intermedia, McLeodUSA/SPLT, XO, Time Warner Telecom, Teligent, Choice One, Allegiance, WinStar, RCN, US LEC, Network Plus, CTC, Focal, Covad, CenturyTel, Alltel, Citizens, Level III, Williams Communications, and Global Crossing.

U.S. Telecommunications Industry

- ◆ Telecom has had the largest number of layoffs of any industry in the last nine out of 12 months, and in 2001
 - » Over 600,000 job cuts have been announced in the telecom sector worldwide since January 2000

Job Cuts Worldwide in the Telecom Sector since January 2001

Company	Jobs Cut	Company	Jobs Cut	Company	Jobs Cut
Nortel Networks	52,000	Cable and Wireless	5,500	Vodafone	960
Lucent Technologies	50,910	NTL	5,000	Northpoint	948
Motorola	42,900	BellSouth	4,200	One2One	900
Ericsson	42,000	Epcos	3,190	Teligent	900
China Unicom	34,478	France Telecom	3,000	Energis	850
Alcatel	33,000	Elcoteq	3,000	Japan Telecom	850
Matsushita	21,000	Celestica	2,900	360networks	800
Solectron	20,700	MMO2	2,550	Genuity	770
Siemens	17,000	Molex	2,500	Optus	700
JDS Uniphase	16,000	Level 3 Communications	2,150	Exodus Communications	675
Qwest Communications	13,000	Oki Electric	2,100	Gemplus	567
Marconi	13,000	McLeodUSA	2,075	Excite@Home	500
Corning	12,000	Conexant Systems	2,075	Zarlink (formerly Mitel)	430
Telekomunikacja Polska SA	12,000	Global Crossing	2,000	Telenor	420
WorldCom	11,700	Mitsubishi Electric	2,000	Comverse Technology	400
Philips	11,570	Tellabs	2,000	Pacific Century Cyberworks	340
AT&T	10,000	Winstar	2,000	Openwave	300
ADC	9,500	Flextronics	1,500	Network Access Solutions	295
Sprint	9,000	Telewest	1,500	Bookham Technology	250
Cisco Systems	8,500	Ciena	1,430	Corvis	250
BT Group	8,200	ECI Telecom	1,400	Globalstar	175
Verizon	7,500	Nokia	1,250	Vitesse Semiconductor	150
Agere Systems	7,300	Covad Communications	1,200	Juniper Networks	104
KPN	6,800	Atlantic Telecom	1,073	Orchestream	94
3Com	6,000	Sonera	1,000	TOTAL	547,279

Source: Financial Times, May 14, 2002.

**SUMMARY OF DATA FOR FCC PRESENTATION
QUESTION #6 AND TSR/S&P 500 P/E QUESTION**

Equity Value Summary

in Millions	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>June-02</u>
ILEC	456,779	458,749	449,870	360,690	277,870
IXC	331,078	469,164	176,106	131,244	53,408
CLEC	10,261	46,405	22,147	5,576	2,236
Equipment Makers	312,759	768,785	1,013,414	320,462	266,708
Total	1,110,877	1,743,102	1,661,537	817,972	600,221

TSR July 2002 YTD

	<u>Total Shareholder Return</u>
BellSouth	-28.87%
SBC	-28.35%
Verizon	-29.27%
Qwest	-90.94%
S&P 500	-19.92%

S&P 500 P/E as of August 7, 2002 market close

16.2

ILEC

Company Name	Market Value[Y98]	Market Value[Y99]	Market Value[Y00]	Market Value[Y01]	Market Value[Q202]
BELLSOUTH CORP	97,655	88,195	76,389	71,608	59,045
BROADWING INC	5,158	4,819	4,937	2,070	569
CITIZENS COMMUNICATIONS CO	@NA	@NA	3,481	2,985	2,356
QWEST COMMUNICATION INTL INC	32,447	36,360	68,139	23,526	4,695
SBC COMMUNICATIONS INC	174,717	165,524	161,632	131,672	101,875
VERIZON COMMUNICATIONS	146,801	163,850	135,292	128,828	109,329
Total ILEC	456,779	458,749	449,870	360,690	277,870

Company Name	Market Value[Y98]	Market Value[Y99]	Market Value[Y00]	Market Value[Y01]	Market Value[Q202]
360NETWORKS INC	@NA	@NA	10,376	70	@NA
ASIA GLOBAL CROSSING LTD	@NA	@NA	3,643	693	@NA
AT&T CORP	132,840	162,378	64,750	64,139	38,160
DESTIA COMMUNICATIONS INC	@NA	@NA	@NA	@NA	@NA
FLAG TELECOM HOLDINGS	@NA	@NA	833	215	10
GLOBAL CROSSING LTD	8,762	38,395	12,635	746	@NA
IDT CORP	721	670	1,248	413	1,320
IMPSAT FIBER NETWORKS INC	@NA	@NA	400	16	2
LEVEL 3 COMMUN INC	13,247	27,894	12,047	1,914	1,160
METROMEDIA FIBER NTWK -CL A	3,161	11,150	5,574	271	@NA
NEON COMMUNICATIONS INC	167	1,019	122	54	1
PACIFIC GATEWAY EXCHANGE INC	922	333	1	@NA	@NA
PRIMUS TELECOMM GROUP INC	463	1,100	93	34	45
RSL COMMUNICATIONS -CL A	1,320	940	10	@NA	@NA
SPRINT FON GROUP	36,233	58,656	17,942	19,829	9,903
STARTEC GLOBAL COMMUNICTNS	86	202	56	1	@NA
TALK AMERICA HOLDINGS INC	844	1,099	112	33	337
TYCOM LTD	@NA	@NA	@NA	@NA	@NA
VIA TEL INC	530	1,750	188	@NA	@NA
WILLIAMS COMMUNICATIONS GRP	@NA	13,414	5,447	1,153	10
WORLD ACCESS INC	487	871	176	@NA	@NA
WORLDCOM INC-WORLDCOM GROUP	131,295	149,295	40,451	41,663	2,459
Total IXC	331,078	469,164	176,106	131,244	53,408

* Based on company grouping by year provided by Morgan Stanley August 8, 2002.

CLEC

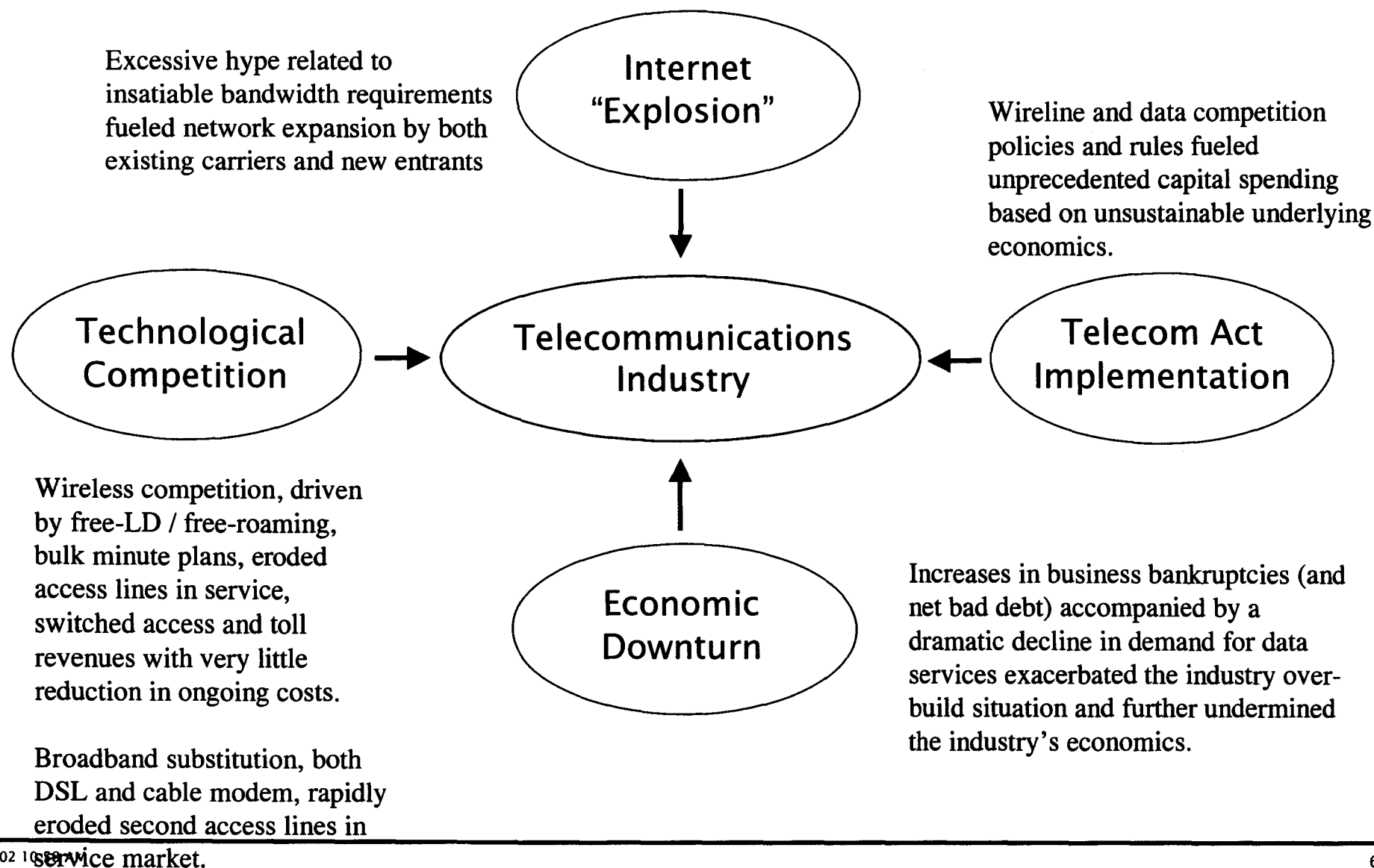
Company Name	Market Value[Y98]	Market Value[Y99]	Market Value[Y00]	Market Value[Y01]	Market Value[Q202]
ADELPHIA BUSINESS SOLUTIONS	827	2,645	301	78	@NA
ADVANCED TELECOMMUN-OLD	@NA	@NA	@NA	@NA	@NA
ALLEGIANCE TELECOM INC	610	5,984	2,429	947	212
ATX COMMUNICATIONS INC	208	1,511	350	16	6
CAPROCK COMMUNICATIONS CORP	@NA	@NA	@NA	@NA	@NA
CHOICE ONE COMMUNICATION INC	@NA	@NA	353	132	36
COMMONWLT H TELE ENTER	616	1,169	795	1,065	943
CONVERGENT COMMUNICATIONS	@NA	444	18	@NA	@NA
CT COMMUNICATIONS INC	339	525	265	310	304
ESPIRE COMMUNICATIONS INC	307	294	27	3	@NA
ELEC COMMUNICATIONS CORP	6	24	11	9	1
ELECTRIC LIGHTWAVE -CL A	407	938	168	15	35
FAIRPOINT COMMUNICATIONS INC	@NA	@NA	@NA	@NA	@NA
FOCAL COMMUNICATIONS CORP	@NA	1,463	429	38	12
GST TELECOMM INC	237	341	0	@NA	@NA
GT GROUP TELECOM INC	@NA	@NA	1,546	@NA	8
HICKORY TECH CORP	178	207	284	236	210
I-LINK INC	40	63	22	9	16
ICG COMMUNICATIONS	985	869	16	3	1
INTERMEDIA COMMUNICATNS INC	@NA	@NA	@NA	@NA	@NA
ITC DELTACOM INC	782	1,641	332	54	4
KMC TELECOM HOLDINGS INC	@NA	@NA	@NA	@NA	@NA
MCLEODUSA INC -CL A	@NA	@NA	@NA	@NA	@NA
MPOWER HOLDING CORP	120	1,157	287	27	1
NET2000 COMMUNICATIONS INC	@NA	@NA	66	0	@NA
NETWORK PLUS CORP	@NA	1,145	154	78	@NA
PAC-WEST TELECOM INC	@NA	938	123	20	16
RCN CORP	1,149	3,702	546	285	139
SPLITROCK SERVICES INC	@NA	@NA	@NA	@NA	@NA
TELIGENT INC	1,512	3,341	123	@NA	@NA
TIME WARNER TELECOM INC	@NA	5,220	6,702	2,023	193
US LEC CORP	406	885	133	141	62
USN COMMUNICATIONS INC	@NA	@NA	@NA	@NA	@NA
WINSTAR COMMUNICATIONS	@NA	@NA	@NA	@NA	@NA
XO COMMUNICATIONS INC -CL A	1,531	11,021	6,490	43	9
Z TEL TECHNOLOGIES INC	@NA	881	175	44	29
Total CLEC	10,261	46,405	22,147	5,576	2,236

* Based on company grouping by year provided by Morgan Stanley August 8, 2002.

Equipment

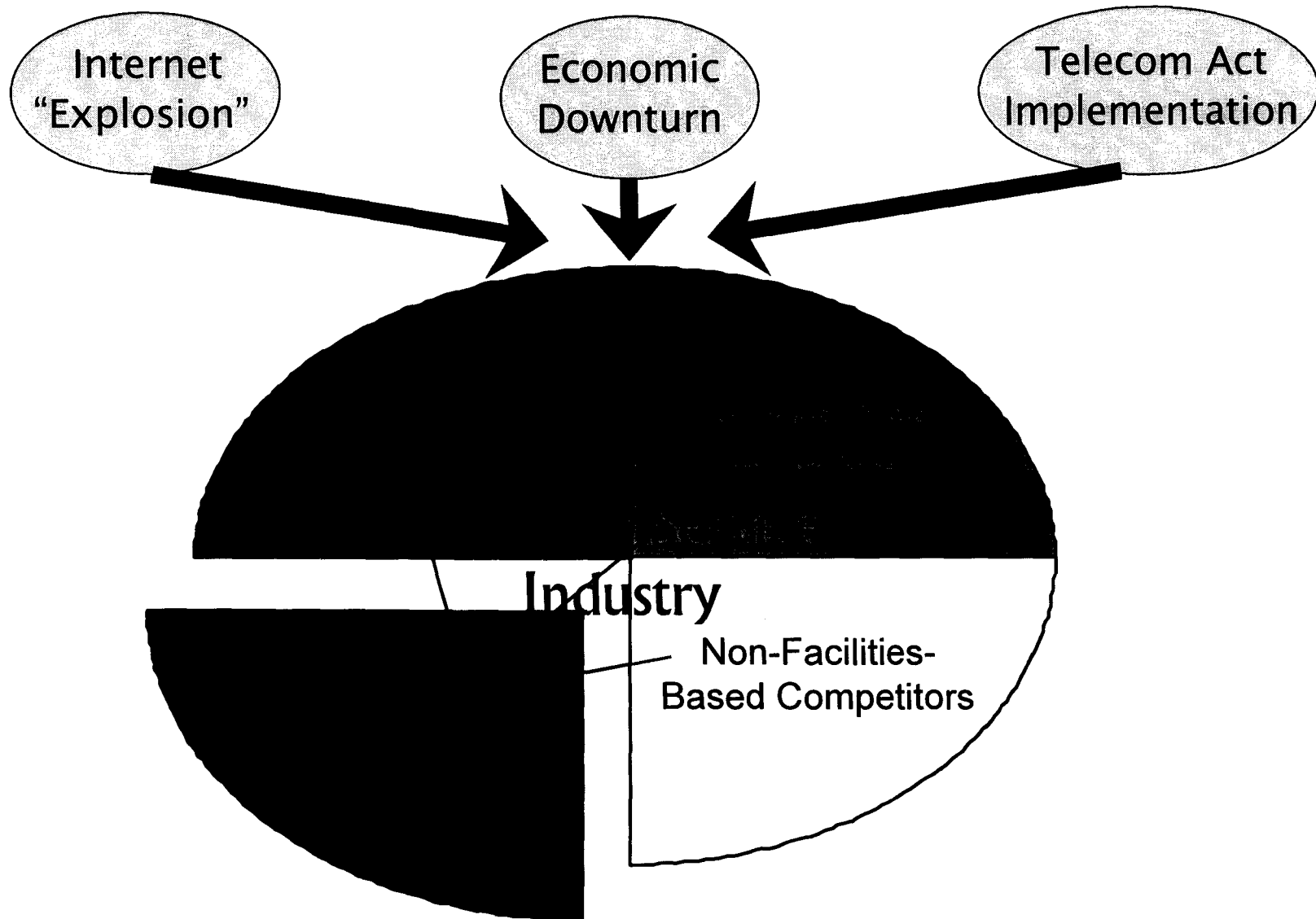
Company Name	Market Value[Y98]	Market Value[Y99]	Market Value[Y00]	Market Value[Y01]	Market Value[Q202]
ADC TELECOMMUNICATIONS INC	3,100	6,480	15,155	3,591	3,089
ADTRAN INC	713	1,973	822	985	733
ADVANCED FIBRE COMM INC	826	3,461	1,456	1,447	1,365
ALLEN TELECOM INC	183	320	502	239	131
ANDREW CORP	1,141	1,426	2,125	1,480	1,368
AUDIOVOX CORP -CL A	123	550	211	158	159
AWARE INC	561	790	400	188	86
BEL FUSE INC	208	293	360	269	284
BROOKTROUT INC	185	203	114	79	70
C-COR.NET CORP	174	254	912	388	522
CABLE DESIGN TECH CP -CL A	611	510	1,012	659	565
CIENA CORP	1,762	4,839	29,836	5,321	2,462
CISCO SYSTEMS INC	99,121	199,670	458,128	140,517	145,231
COMMSCOPE INC	827	2,048	849	1,095	772
COMVERSE TECHNOLOGY INC	3,722	10,804	18,776	3,975	1,489
CONCERTO SOFTWARE INC	109	259	126	121	78
CORNING INC	10,400	31,551	46,623	8,224	3,373
DMC STRATEX NETWORKS INC	518	2,359	612	448 @NA	218
HARMONIC INC	219	2,877	329	709	218
HARRIS CORP	3,575	3,126	2,265	1,791	2,010
INTER-TEL INC -SER A	611	648	203	455	410
JDS UNIPHASE CORP	2,191	6,704	93,748	16,453	10,192
LUCENT TECHNOLOGIES INC	90,985	197,803	102,064	19,540	16,191
MOTOROLA INC	36,648	89,689	44,233	33,431	33,131
NORTEL NETWORKS CORP	33,174	137,524	96,236	23,939	5,446
PLANTRONICS INC	1,046	1,508	874	980 @NA	
POLYCOM INC	757	2,091	2,428	2,862	1,200
POWERWAVE TECHNOLOGIES INC	321	1,169	3,696	1,114	599
QUALCOMM INC	3,356	28,378	53,085	36,151	28,876
SCIENTIFIC-ATLANTA INC	1,995	2,751	11,857	6,572	3,741
SYMMETRICOM INC	95	122	381	347	171
TELLABS INC	13,318	25,821	23,194	6,133	2,547
TOLLGRADE COMMUNICATIONS INC	114	199	470	436	199
VIASAT INC	71	587	332	363 @NA	
Total Communications Equipment	312,759	768,785	1,013,414	320,462	266,708

- **The massive excess capacity within the Telecom industry was the result of four contributing dynamics.**



What Happened?

- **The massive excess capacity within the Telecom industry was the result of three contributing dynamics all of which put tremendous financial pressure on the ILECs.**



Proposed Regulatory Solutions

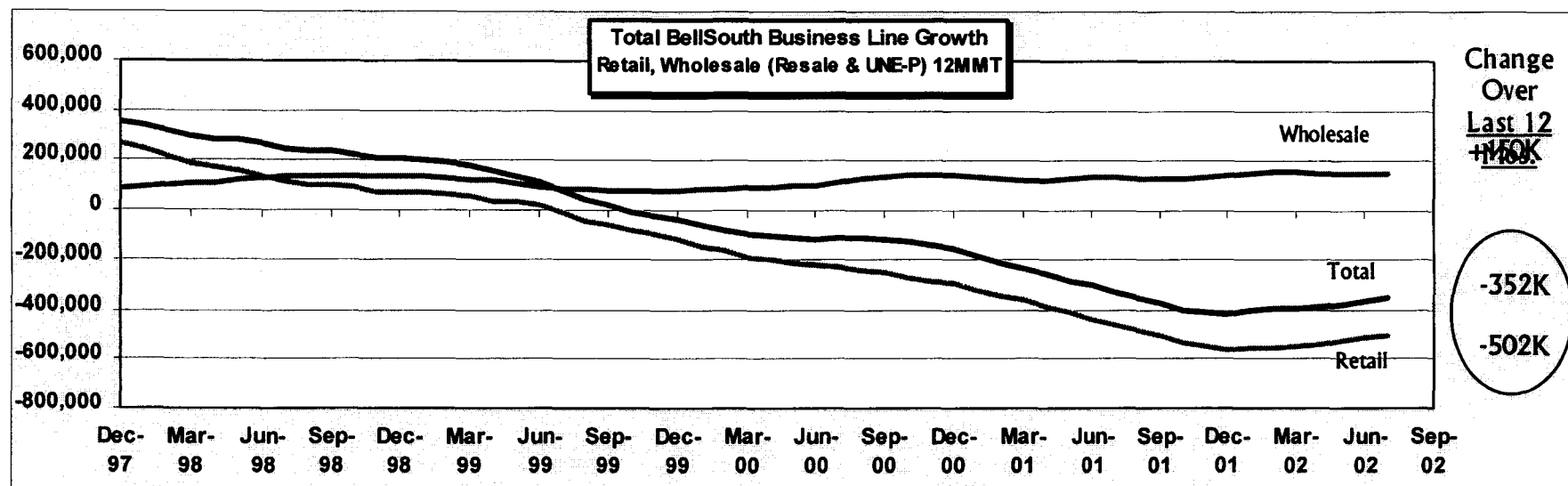
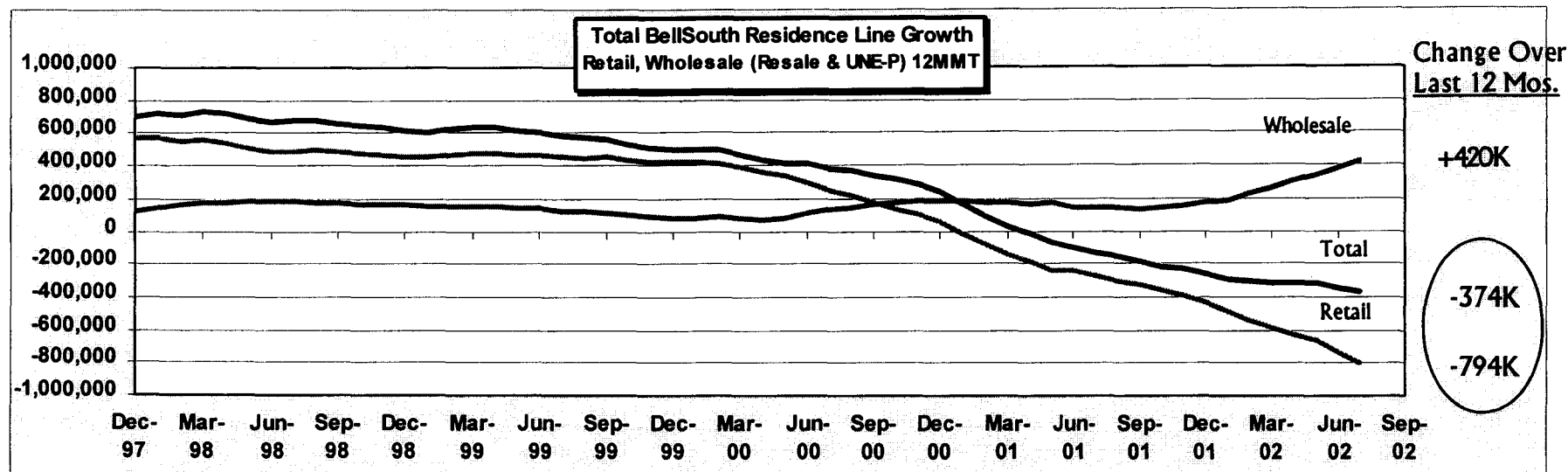
- It is imperative that immediate changes be made to the regulatory framework to stabilize the telecom industry.

Unrestrained Entry	<ul style="list-style-type: none"> ▪ Certify financial integrity and business models of new entrants ▪ Require investment in facilities within some specified timeframe
Shortcomings in UNE Rules	<ul style="list-style-type: none"> ▪ Move toward class-of-service-specific and market-based rates ▪ Impose sunset limits on UNE-P ▪ Restrict UNE-P to non-competitive areas ▪ Continue safe-harbor local service restrictions ▪ Require CLEC to submit to ILEC audits as allowed by regulations. Introduce penalties to discourage representation of facilities as local in order to circumvent use restrictions[#]
Cumbersome Operating Requirements	<ul style="list-style-type: none"> ▪ Move to Bill-and-Keep with respect to Interconnection ▪ Restructure collocation rates to allow for greater up-front recovery of ILEC investment ▪ Limit the number of elements that are required to be unbundled ▪ Eliminate or "grandfather" elements that have zero or insignificant demand
Inequitable and Dual Standards	<ul style="list-style-type: none"> ▪ Address ILEC and CATV open facilities access in a uniform manner ▪ Do not require unbundling of advanced services ▪ Adjust UNE rates to reflect residential/rural subsidies ▪ Allow ILECs pricing flexibility to align residential rates more closely with cost ▪ Simplify and standardize service measurement requirements ▪ Establish uniform LEC standards for customer transfers ▪ Establish procedures for disconnecting service to CLECs in prolonged non-payment situations

[#] 14 of 15 CLECs objected to an audit by BellSouth. The matter has been escalated to the FCC.

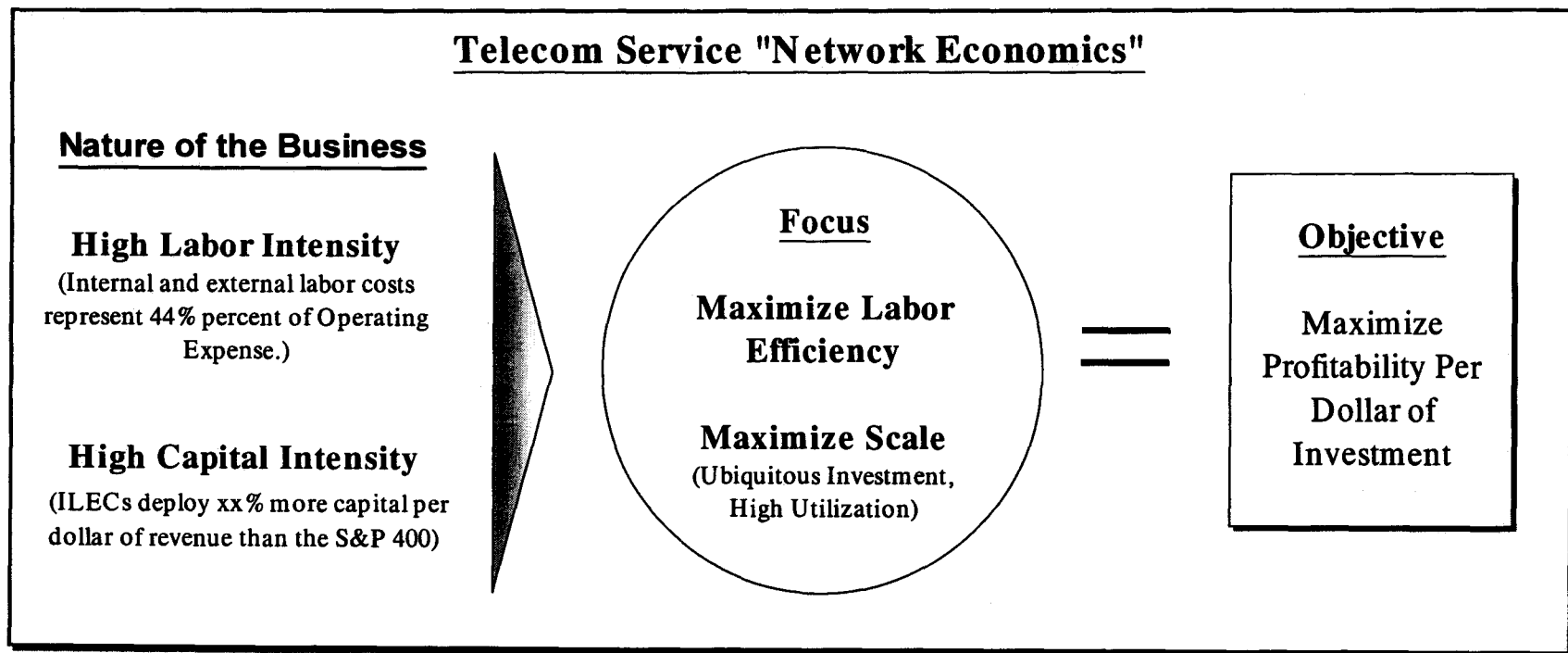
Current State of BellSouth's Wireline Business – Competition

- Access line losses in the Residential market have been driven by both wireline and wireless competition. Recent increased focus by AT&T and MCI on the Residential market in our top metros is evident. Competitive access line loss in the Business market has also been substantial.



Current State of BellSouth's Wireline Business – Cost Structure

- Although regulatory frameworks have changed, the economics of managing a labor- and capital-intensive business, such as Telecom service, have not changed over the last 120 years . . .



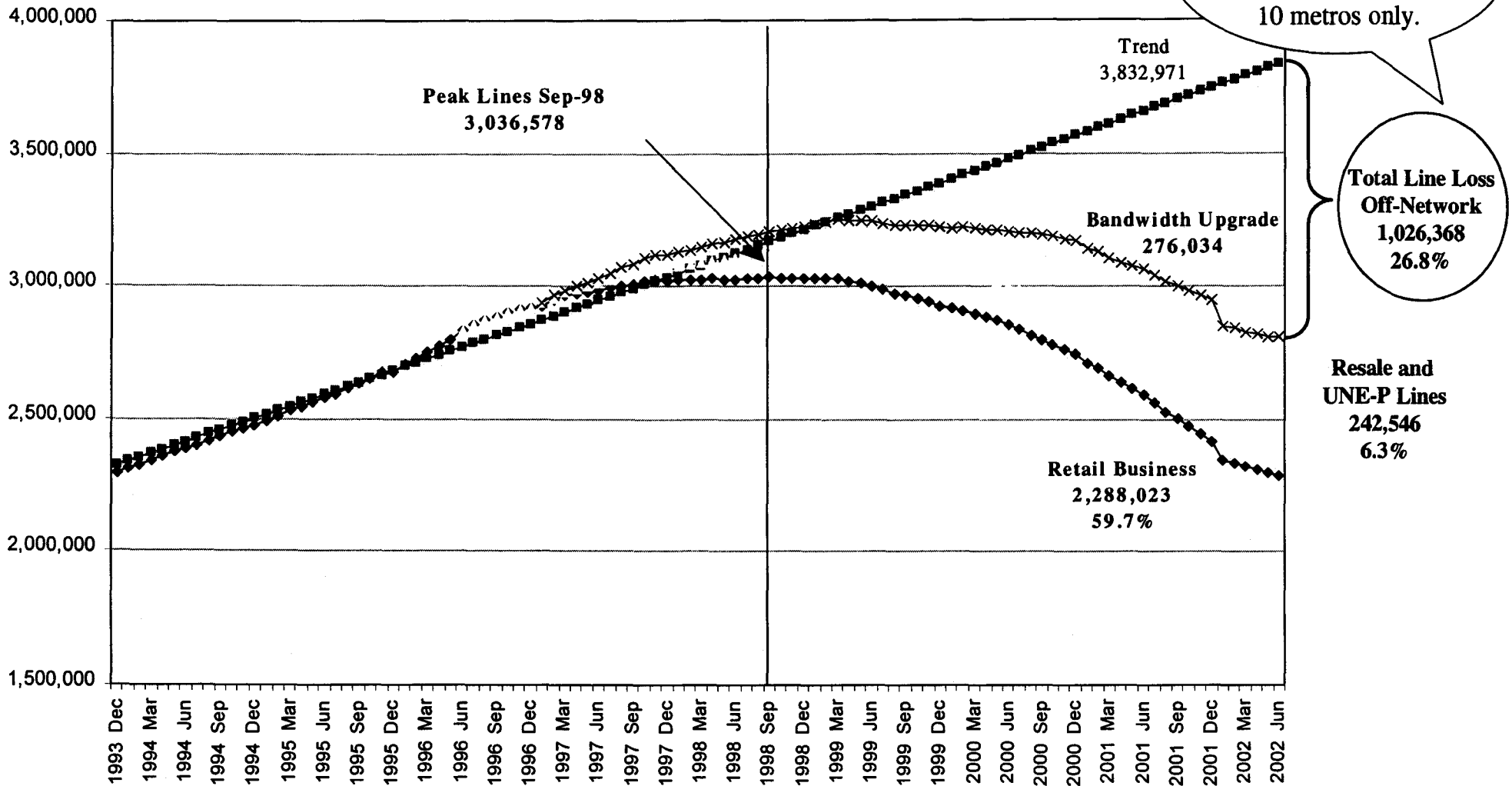
... in the end, the fundamental of issue in most CLEC failures related to the inability to manage these "network economics."

Equity Issues Related to the Regulatory Treatment of ILECS vs. CATV

Regulatory Requirement	Applies to local phone co. DSL?	Applies to Cable?	Applies to Satellite?	Applies to Fixed Wireless ?
Common carrier duty to provide service at just and reasonable prices	Yes	No	No	No
Common carrier duty prohibiting discriminatory treatment	Yes	No	No	No
Duty to provide network to internet service providers	Yes	No	No	No
Duty to file tariffs	Yes	No	No	No
Duty to follow detailed system of regulatory accounting	Yes	No	No	No
Depreciation charges set by regulators	Yes	No	No	No
Duty to interconnect with competitors at below cost prices	Yes	No	No	No
Duty to resell services at government-set discounts	Yes	No	No	No
Duty to negotiate with competitors for access to network	Yes	No	No	No
Duty to provide competitors with piece parts of the network at below cost prices – piece parts such as	Yes	No	No	No
• connections to the house or business for high speed Internet access				
• transport for high speed Internet access				
• computer systems for ordering service				
Duty to allow competitors to locate their equipment at company premises at below cost prices	Yes	No	No	No
Duty to provide dialing parity	Yes	No	No	No
Duty to pay reciprocal compensation	Yes	No	No	No
Duty to provide subscriber list information	Yes	No	No	No
Duty to provide number portability	Yes	No	No	No
Government approval needed to provide long distance voice service	Yes	No	No	No
Requirement to provide equal access to long distance providers	Yes	No	No	No
Government approval needed to provide long distance Internet service	Yes	No	No	No
Duty provide long distance service only through a separate corporate subsidiary	Yes	No	No	No
Duty to support universal service	Yes	No	No	No

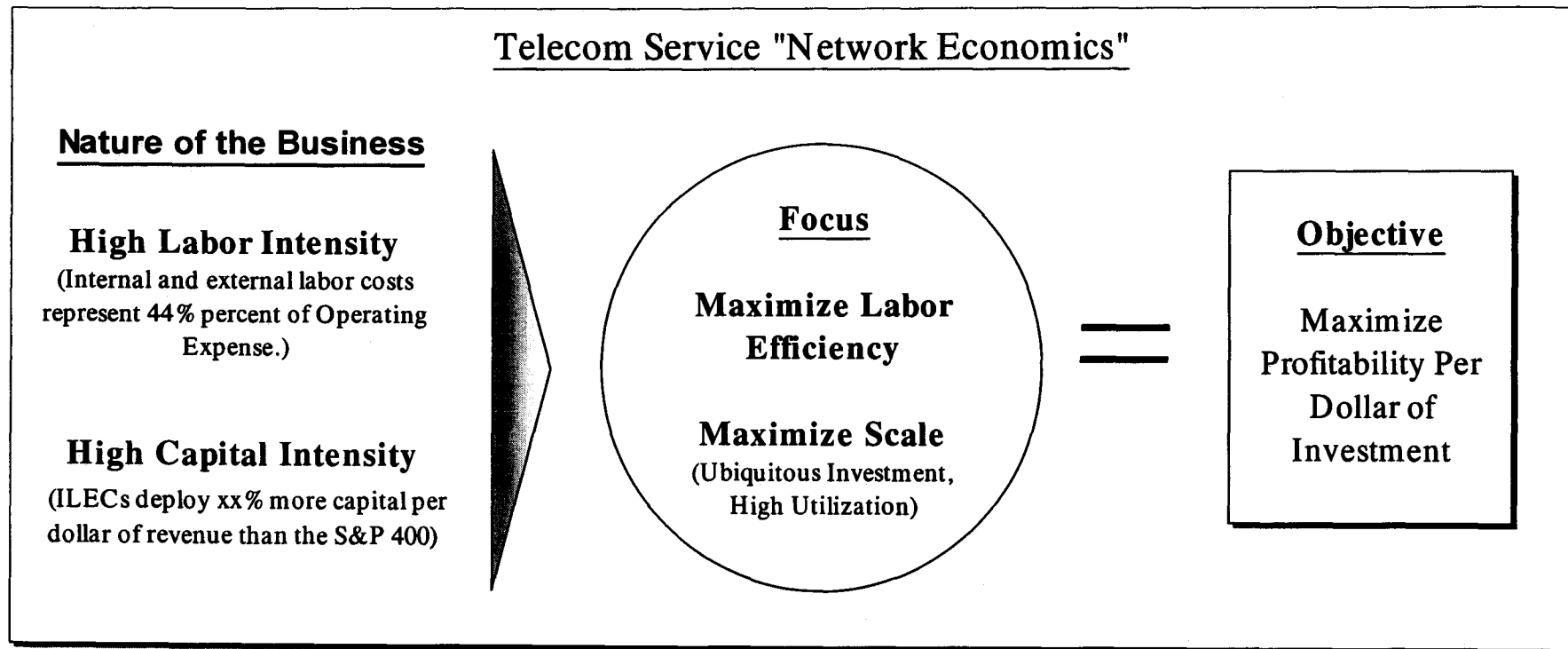
Current State of BellSouth's Wireline Business – Competition

- The competitive impact on BellSouth's business segment has been the greatest in its Top 10 Metros where customer density and regulatory subsidies are the highest.



Current State of BellSouth's Wireline Business – Cost Structure

- Although regulatory frameworks have changed, the economics of managing a labor- and capital-intensive business, such as Telecom service, have not changed over the last 120 years . . .



. . . in the end, the fundamental of issue in most CLEC failures related to the inability to manage these "network economics."

Telecom Act Implementation: Unrestrained Entry (and Re-Entry)

- Unrestrained entry into the Telecom industry has fueled over-capacity, increased industry costs (including net bad debt and churn), and undermined the business models of **all facilities-based competitors**.

Make what is underlined
points on slide. Move rest to
notes

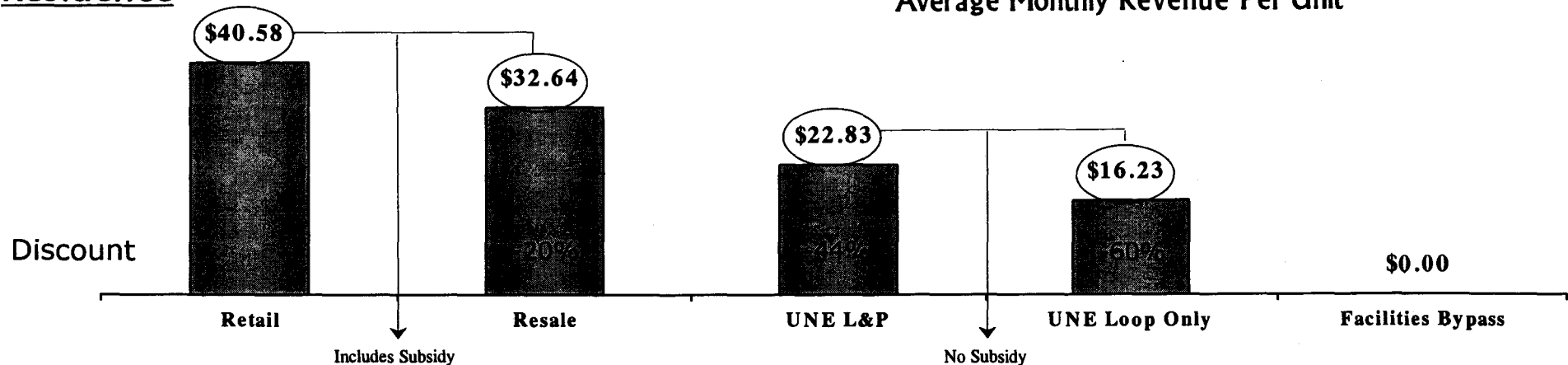
- Unrestrained entry has led to a glut of uneconomic CLECs, many with unsound business models. Some CLECs were initially designed to exploit unsustainable arbitrage opportunities (principally reciprocal compensation arrangements) within the Act. Many are now created for the sole purpose of exploiting UNE-P with no intent to deploy facilities and no meaningful capital at risk.
- The immense number of players has increased industry costs including operating support systems requirements, interconnection facilities, and costs associated with customer churn between carriers. In addition, the high number of bankruptcies has increased industry net bad debt (due to the interconnectedness and interdependence of the industry) and increased the costs of capital to the industry.
- In the end, unrestricted industry access has disadvantaged all facility-based competitors. First came over-capacity financed with high debt levels. Then came non-facility-based competition which further pressured network economics leading to a high rate of business failures (bankruptcies). Resulting in a growing portion of the industry with over-capacity and light debt loads. Which will put further pressure on the rest of the industry.

Telecom Act Implementation: Uneconomic Competitive Rules

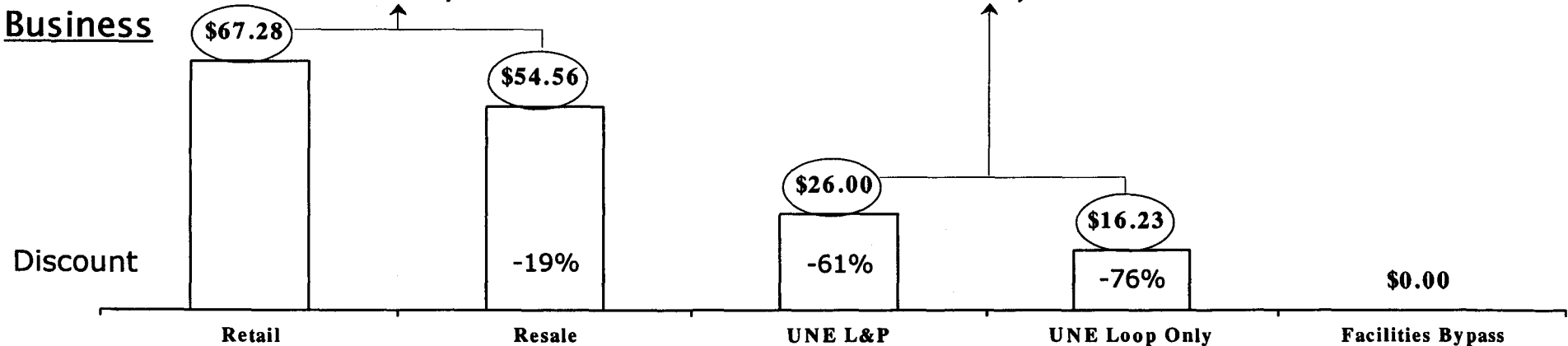
- ... the embedded subsidies are even more evident when you look at the total revenue per per access line ...

Residence

Average Monthly Revenue Per Unit



Business



... placing ILECs at a significant competitive disadvantage in that they bear the entire framework of subsidies built into their rates (where margins are richer in business than residence, and in urban than rural), allowing CLECs to cream-skim the highest value customers ...

Telecom Act Implementation: Inequitable and Dual Standards

- **The list of Inequitable and Dual Regulation Standards that exists between ILECs and their competitors is lengthy but all share the commonality of disadvantaging the ILEC competitive position.**

- The inequities in ILEC regulatory treatment relative to its CATV competitors are extensive (see page 37) and particularly serious since CATV companies continue to mount one of the strongest offensives.
 - » The FCC has **imposed line-sharing and resale obligation** on the ILECs related to DSL, while CATV companies are not required to open their networks to ISPs.

 - » The FCC has imposed **USF payment requirements** on wholesale DSL while requiring no such contributions from cable modem. In the second quarter of 2002, BellSouth's payments in this regard totaled \$7 million.

 - » In light of the potential application of the UNE pricing standard, it is not surprising that uncertainty around likely regulatory treatment of new products has provided an innovation disincentive to the ILECs.

Telecom Act Implementation: Inequitable and Dual Standards

(Continued)

- The ILECs are held to different service standards than their CLEC competitors as well.
 - » Services standards, imposed with good intentions (i.e., to ensure that ILECs provided services to CLECs at parity with the level provided to their Retail customers), are ever-changing and excessive in number. BellSouth reports over 2,300 unique measurements each month, some at a state- and/or CLEC-specific level.
 - » In addition to paying \$42 million in penalties during 2001, BellSouth spent another \$135 million building systems to track measurements and to conduct third-party testing. CLECs are not subject to similar penalties - even if the *ILEC* service “miss” was caused by *CLEC* action.
 - » ILECs are also required to open up their OSS to facilitate the movement of its customers to CLECs, but no reciprocal arrangements are required of the CLECs for either ILEC “reacquisitions” or CLEC-to-CLEC moves.
 - » ILECs are required to bear the cost recovery risk associated with provision of collocation facilities ordered by CLECs. Massive over-ordering during the Internet boom resulted in large amounts of expenditures (over \$250 million by BellSouth), followed by subsequent disconnects, bankruptcies and abandonments. *(57% of BellSouth’s Collocation accounts receivable were over 90 days past due on 03/31/02.)*

Telecom Act Implementation: Inequitable and Dual Standards

(Continued)

- Finally, the ILECs continue to be hobbled by State PSC requirements to subsidize residence and rural services.
 - » In contrast, the CLECs are allowed to cream-skim customers in areas where subsidies are the highest using ILEC facilities at below-cost UNE rates.
 - » As shown previously, this situation is bleeding the very ILEC margins that allow the desired subsidies and cannot persist over time.